MATRIX SERVICE CO
Form 10-Q
January 04, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended November 30, 2006

or

¨ Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the transition period from ______ to ______

Commission File number 001-15461

MATRIX SERVICE COMPANY

(Exact name of registrant as specified in its charter)

DELAWARE	**73-1352174**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

10701 E. Ute St., Tulsa, Oklahoma 74116-1517

(Address of principal executive offices and zip code)

Registrant s telephone number, including area code: (918) 838-8822

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of January 3, 2007, there were 24,686,782 shares of the Company s common stock, $0.01 par value per share, issued and 23,038,896 shares outstanding.

Table of Contents

INDEX

Table of Contents

PART I

FINANCIAL INFORMATION

ITEM 1. Financial St atements

Mat rix Service Company

Consolidated Statements of Operations

(In thousands, except share and per share data)

	Three Months Ended November 30, 2006	Three Months Ended November 30, 2005	Six Months Ended November 30, 2006	Six Months Ended November 30, 2005
	(unaudited)		(unaudited)	
Revenues	$ 166,366	$ 126,778	$ 293,225	$ 235,774
Cost of revenues	144,464	113,819	258,016	212,632
Gross profit	21,902	12,959	35,209	23,142
Selling, general and administrative expenses	8,703	7,487	16,387	14,694
Impairment and abandonment costs		70		70
Restructuring	46	45	46	367
Operating income	13,153	5,357	18,776	8,011
Other income (expense):				
Interest expense	(759)	(2,638)	(1,505)	(5,415)
Interest income	29	2	58	9
Other	198	838	302	1,568
Income before income taxes	12,621	3,559	17,631	4,173
Provision for federal, state and foreign income taxes	4,547	1,391	6,549	1,630
Net income	$ 8,074	$ 2,168	$ 11,082	$ 2,543
Basic earnings per common share	$ 0.35	$ 0.11	$ 0.50	$ 0.14
Diluted earnings per common share	$ 0.31	$ 0.10	$ 0.43	$ 0.13
Weighted average common shares outstanding:				
Basic	23,004,171	19,537,664	22,252,486	18,477,718
Diluted	26,589,115	25,693,625	26,572,376	24,881,711

See accompanying notes.

Table of Contents

Matrix Se rvice Company

Consolidated Balance Sheets

(In thousands)

	November 30, 2006 (unaudited)	May 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 5,092	$ 8,585
Receivables, less allowances (November 30, 2006 - $245 and May 31, 2006 - $190)	80,261	64,061
Contract disputes receivable	975	11,668
Costs and estimated earnings in excess of billings on uncompleted contracts	27,181	24,538
Prepaid expenses	5,031	5,581
Inventories	5,553	4,738
Income tax receivable		104
Deferred income taxes	647	2,831
Assets held for sale	809	809
Total current assets	125,549	122,915
Property, plant and equipment at cost:		
Land and buildings	23,194	23,100
Construction equipment	35,264	31,081
Transportation equipment	12,348	10,921
Furniture and fixtures	9,147	8,658
Construction in progress	2,092	2,392
	82,045	76,152
Accumulated depreciation	(40,989)	(38,712)
	41,056	37,440
Goodwill	23,356	23,442
Other assets	6,353	4,479
Total assets	$ 196,314	$ 188,276

See accompanying notes.

-2-

Table of Contents

Matrix Service Company

Consolidated Balance Sheets

(In thousands, except share data)

	November 30, 2006 (unaudited)	May 31, 2006
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 35,390	$ 47,123
Billings on uncompleted contracts in excess of costs and estimated earnings	20,814	12,078
Accrued insurance	5,071	6,408
Other accrued expenses	13,392	12,436
Income tax payable	330	
Current capital lease obligation	471	406
Current portion of acquisition payable	1,854	1,808
Total current liabilities	77,322	80,259
Deferred income taxes	3,461	3,502
Long-term capital lease obligation	416	538
Long-term acquisition payable	2,644	2,578
Convertible notes	15,000	25,000
Stockholders equity:		
Common stock - $.01 par value; 60,000,000 shares authorized; 24,686,782 and 22,595,243 shares issued as of November 30, 2006 and May 31, 2006	247	226
Additional paid-in capital	85,883	75,855
Retained earnings	15,374	4,316
Accumulated other comprehensive income	539	814
	102,043	81,211
Less: Treasury stock, at cost 1,649,886 and 1,731,386 shares as of November 30, 2006 and May 31, 2006	(4,572)	(4,812)
Total stockholders equity	97,471	76,399
Total liabilities and stockholders equity	$ 196,314	$ 188,276

See accompanying notes.

-3-

Table of Contents

Matrix Service Company

Consolidated Statements of Cash Flows

(In thousands)

	Six Months Ended November 30, 2006	Six Months Ended November 30, 2005
	(unaudited)	
Operating activities:		
Net income	$ 11,082	$ 2,543
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	3,031	2,864
Impairment loss		70
Deferred income tax	2,143	(462)
Gain on sale of property, plant and equipment	(119)	(1,562)
Allowance for uncollectible accounts	65	465
Stock-based compensation expense	473	
Accretion on acquisition payable	112	153
Amortization of debt issuance costs	263	2,222
Amortization of prepaid interest	642	1,016
Changes in operating assets and liabilities increasing (decreasing) cash		
Receivables	(5,572)	6,340
Costs and estimated earnings in excess of billings on uncompleted contracts	(2,643)	(5,809)
Inventories	(815)	7
Prepaid expenses and other assets	(3,094)	(249)
Accounts payable	(11,455)	(5,008)
Billings on uncompleted contracts in excess of costs and estimated earnings	8,736	1,082
Accrued expenses	(381)	(1,905)
Income tax receivable/payable	434	2,421
Other		(9)
Net cash provided by operating activities	2,902	4,179
Investing activities:		
Acquisition of property, plant and equipment	(6,777)	(2,075)
Proceeds from asset sales	142	6,269
Net cash provided (used) by investing activities	$ (6,635)	$ 4,194

-4-

Table of Contents

Matrix Service Company

Consolidated Statements of Cash Flows (continued)

(In thousands)

	Six Months Ended November 30, 2006 (unaudited)	Six Months Ended November 30, 2005
Financing activities:		
Advances under bank credit facility	$ 85,635	$ 72,201
Repayments of bank credit facility	(85,635)	(94,900)
Payment of credit facility refinancing fees	(25)	
Capital lease payments	(254)	(159)
Capital lease borrowings		662
Issuances of common stock	437	15,024
Repayment of acquisition payable		(382)
Tax benefit of exercised stock options		

	23ng Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock that have not Vested (#)	Market Value of Shares or Units of Stock that have not Vested ($)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights that have not Vested ($)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights that have not Vested ($)
(a)	(b)	(c)	(d)	(e)	(e)	(g)	(h)	(i)	(j)
Eric S. Langan	5,000	0	0	1.40	9/10/08	0	0	0	0
	75,000	0	0	2.20	2/6/09	0	0	0	0
	5,000	0	0	2.54	9/14/09	0	0	0	0
	200,000	0	0	2.49	9/14/09	0	0	0	0
	5,000	0	0	2.80	7/20/10	0	0	0	0
	5,000		0	6.75	5/31/11	0	0	0	0
		5,000	0	9.40	8/24/09	5,000	58,200	0	0

Phillip Marshall	0	20,000	0	9.40	8/24/12	20,000	232,800	0	0
Travis Reese	5,000	0	0	2.54	9/14/09	0	0	0	0
	50,000	0	0	2.49	9/14/09	0	0	0	0
	5,000	0	0	2.80	7/20/10	0	0	0	0
	5,000		0	6.75	5/31/11	0	0	0	0
		5,000	0	9.40	8/24/09	5,000	58,200	0	0

DIRECTOR COMPENSATION

We do not currently pay any cash directors' fees, but we pay the expenses of our directors in attending board meetings. In August 2007, we issued 10,000 stock options to each Director who is a member of our Audit Committee and 5,000 options to our other Directors. These options become exercisable on August 24, 2008, have a strike price of $9.40 per share and expire in August 2009.

Name (a)	Fees Earned or Paid in Cash ($) (b)	Stock Awards ($) (c)	Option Awards ($) (d)	Non-Equity Incentive Plan Compensation ($) (e)	Nonqualified Deferred Compensation Earnings ($) (f)	All Other Compensation ($) (g)	Total ($) (h)
Eric S. Langan	-0-	-0-	$ 19,375(1)	-0-	-0-	-0-	$ 19,375
Travis Reese	-0-	-0-	$ 24,150(2)	-0-	-0-	-0-	$ 24,150
Robert Watters	-0-	-0-	$ 38,750(3)	-0-	-0-	-0-	$ 38,750
Alan Bergstrom	-0-	-0-	$ 38,750(4)	-0-	-0-	-0-	$ 38,750
Steve Jenkins	-0-	-0-	$ 38,750(5)	-0-	-0-	-0-	$ 38,750
Luke Lirot	-0-	-0-	$ 4,283(6)	-0-	-0-	-0-	$ 4,283

8

1 On August 24, 2007, Mr. Langan received 5,000 options to purchase shares of our common stock at an exercise price of $9.40 as Director compensation for the fiscal year ending September 30, 2008; these options will vest on August 24, 2008. Mr. Langan received 5,000 options in fiscal 2003, 280,000 in fiscal 2004, 5,000 in fiscal 2005, and 5,000 in fiscal 2006, for a total of 295,000 options outstanding as of September 30, 2007.

2 On August 24, 2007, Mr. Reese received 5,000 options to purchase shares of our common stock at an exercise price of $9.40 as Director compensation for the fiscal year ending September 30, 2008; these options will vest on August 24, 2008. Mr. Reese received 5,000 options in fiscal 2003, 55,000 in fiscal 2004, 5,000 in fiscal 2005, and 5,000 in fiscal 2006, for a total of 75,000 options outstanding as of September 30, 2007 .

3 On August 24, 2007, Mr. Watters received 10,000 options to purchase shares of our common stock at an exercise price of $9.40 as Director compensation for the fiscal year ending September 30, 2008; these options will vest on August 24, 2008. Mr. Watters received 10,000 options for each of the fiscal years 2003, 2004, 2005, 2006, and had 40,000 options outstanding as of September 30, 2007 .

4 On August 24, 2007, Mr. Bergstrom received 10,000 options to purchase shares of our common stock at an exercise price of $9.40 as Director compensation for the fiscal year ending September 30, 2008; these options will vest on August 24, 2008. Mr. Bergstrom received 10,000 options for fiscal years 2003, 2004, 2005 and 2006 and had 20,000 options outstanding as of September 30, 2007 .

5 On August 24, 2007, Mr. Jenkins received 10,000 options to purchase shares of our common stock at an exercise price of $9.40 as Director compensation for the fiscal year ending September 30, 2008; these options will vest on August 24, 2008. Mr. Jenkins received 10,000 options for fiscal years 2003, 2004, 2005 and 2006 and had 10,000 options outstanding as of September 30, 2007.

6 On August 24, 2007, Mr. Lirot received 10,000 options to purchase shares of our common stock at an exercise price of $9.40 as Director compensation for the fiscal year ending September 30, 2008; these options will vest on August 24, 2008.

EMPLOYMENT AGREEMENTS

We have a two year employment agreement with Eric S. Langan. Mr. Langan’s Employment Agreement extends through April 1, 2010 and provides for an annual base salary of $600,000. Mr. Langan’s Employment Agreement also provides for participation in all benefit plans maintained by us for salaried employees. Mr. Langan’s Employment Agreement contains a confidentiality provision and an agreement by Mr. Langan not to compete with us upon the expiration of his Employment Agreement.

We also entered into a two year Employment Agreement with Phillip K. Marshall to serve as our Chief Financial Officer. Mr. Marshall’s Employment Agreement extends through May 30, 2009, and provides for an annual base salary of $175,000. Pursuant to Mr. Marshall’s Employment Agreement, Mr. Marshall is also eligible to participate in all benefit plans maintained by us for salaried employees. Under the terms of his Employment Agreement, Mr. Marshall is bound to a confidentiality provision and cannot compete with us upon the expiration of his Employment Agreement.

We also have a three-year employment agreement with Travis Reese. Mr. Reese’s Employment Agreement extends through February 1, 2010, and provides for an annual base salary of $192,500. Mr. Reese’s Employment Agreement also provides for participation in all benefit plans maintained by us for salaried employees. Mr. Reese is bound to a confidentiality provision and cannot compete with us upon the expiration of his Employment Agreement.

We have not established long-term incentive plans or defined benefit or actuarial plans.

EMPLOYEE STOCK OPTION PLANS

While we have been successful in attracting and retaining qualified personnel, we believe that our future success will depend in part on our continued ability to attract and retain highly qualified personnel. We pay wages and salaries that we believe are competitive. We also believe that equity ownership is an important factor in our ability to attract and retain skilled personnel. We have adopted Stock Option Plans for employee and directors. The purpose of the Plans is to further our interests, our subsidiaries and our stockholders by providing incentives in the form of stock options to key employees and directors who contribute materially to our success and profitability. The grants recognize and reward outstanding individual performances and contributions and will give such persons a proprietary interest in the Company, thus enhancing their personal interest in our continued success and progress. The Plans also assist the Company and our subsidiaries in attracting and retaining key employees and directors. The Plans are administered by the Board of Directors. The Board of Directors has the exclusive power to select the participants in the Plans, to establish the terms of the options granted to each participant, provided that all options granted shall be granted at an exercise price equal to at least 85% of the fair market value of the common stock covered by the option on the grant date and to make all determinations necessary or advisable under the Plans.

In 1995 we adopted the 1995 Stock Option Plan. A total of 300,000 shares may be granted and sold under the 1995 Plan. As of September 30, 2001, a total of 167,500 stock options had been granted and are outstanding under the Plan, none of which have been exercised. We do not plan to issue any additional options under the 1995 Plan.

In August 1999 we adopted the 1999 Stock Option Plan (the “1999 Plan”) with 500,000 shares authorized to be granted and sold under the 1999 Plan. In August 2004, shareholders approved an Amendment to the 1999 Plan which increased the total number of shares authorized to 1,000,000. In July 2007, shareholders approved a Second Amendment to the 1999 Plan which increased the total number of shares authorized to 1,500,000. As of September 30, 2007, 545,000 stock options were outstanding under the 1999 Plan, as amended. As of June 27, 2008, 40,000 of these stock options have been exercised.

EQUITY COMPENSATION PLAN INFORMATION (1)

The following table sets forth all equity compensation plans as of September 30, 2007:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	545,000	$ 3.61	438,000

10

SECURITY OWNERSHIP OF
CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information at June 27, 2008, with respect to the beneficial ownership of shares of Common Stock by (i) each person known to us who owns beneficially more than 5% of the outstanding shares of Common Stock, (ii) each of our directors, (iii) each of our executive officers and (iv) all of our executive officers and directors as a group. Unless otherwise indicated, each stockholder has sole voting and investment power with respect to the shares shown. As of June 27, 2008, there were 8,825,447 shares of common stock outstanding.

Name/Address	Number of shares	Title of class	Percent of Class (13)
Eric S. Langan President/CEO/Director 10959 Cutten Road Houston, Texas 77066	1,199,865(1)	Common stock	13.16%
Robert L. Watters/Director 315 Bourbon Street New Orleans, Louisiana 70130	55,000(2)	Common stock	<1%
Steven L. Jenkins/Director 16815 Royal Crest Drive Suite 160 Houston, Texas 77058	10,000(3)	Common stock	<1%
Travis Reese Vice President/Director 10959 Cutten Road Houston, Texas 77066	77,275(4)	Common stock	<1%
Alan Bergstrom/Director 904 West Avenue, Suite 100 Austin, Texas 78701	11,150(5)	Common stock	<1%
Luke Lirot/Director 2240 Belleair Road, Suite 190 Clearwater, GL 33764	10,000(6)	Common stock	<1%
Phillip K. Marshall Chief Financial Officer 10959 Cutten Road Houston, Texas 77066	10,000(7)	Common stock	<1%
All of our Directors and Officers as a Group of seven (7) persons	1,373,290(8)	Common stock	14.8%
E. S. Langan. L.P. 10959 Cutten Road Houston, Texas 77066	578,632(9)	Common stock	6.56%
JLF Asset Management/Jeff Feinberg 2775 Via D La Valle, Suite 204 Del Mar, CA 92014	575,098(10)	Common stock	6.51%
Estate of Ralph McElroy 1211 Choquette Austin, Texas, 78757	978,116(11)	Common stock	10.75%

Burlingame Asset Management/ Blair Sanford One Market Street Suite 3750 San Francisco, CA 94105	460,223(12)	Common stock	5.21%

11

(1) Mr. Langan has sole voting and investment power for 326,233 shares that he owns directly. Mr. Langan has shared voting and investment power for 578,632 shares that he controls indirectly through E. S. Langan, L.P. Mr. Langan is the general partner of E. S. Langan, L.P. This amount also includes options to purchase up to 290,000 shares of common stock that are presently exercisable and 5,000 shares of common stock that will become exercisable in August 2008.

(2) Includes 5,000 shares of common stock, options to purchase up to 40,000 shares of common stock that are presently exercisable and options to purchase up to 10,000 shares of common stock that will become exercisable in August 2008.

(3) Includes options to purchase up to 10,000 shares of common stock that will become exercisable in August 2008.

(4) Includes 12,275 shares of common stock held, options to purchase up to 60,000 shares of common stock that are presently exercisable and options to purchase 5,000 shares of common stock that will become exercisable in August 2008.

(5) Includes 1,150 shares of common stock and options to purchase up to 10,000 shares of common stock that will become exercisable in August 2008.

(6) Includes options to purchase up to 10,000 shares of common stock that will become exercisable in August 2008.

(7) Includes options to purchase up to 10,000 shares of common stock that will become exercisable in August 2008.

(8) Includes options to purchase up to 390,000 shares of common stock that are presently exercisable and options to purchase 60,000 shares of common stock that will become exercisable in August 2008.

(9) Eric Langan is the general partner of this entity and has shared voting and investment power for these shares.

(10) Includes 244,819 shares of common stock held by JLF Partners I, LP, 18,563 shares of common stock held by JLF Partners II, LP, and 311,716 shares of common stock held by JLF Offshore Fund, Ltd. Mr. Feinberg is the managing member of JLF Asset Management, LLC, which is the investment manager of JLF Partners I, LP, JLF Partners, II, LP and JLF Offshore Fund, Ltd.

(11) Mr. McElroy passed away on July 26, 2007. The Estate of Ralph McElroy is currently being administered by the Executor and holds 708,116 shares of common stock and 50,000 warrants to purchase shares of common stock that are presently exercisable at $3.00 per share. This number also includes shares of our common stock underlying a convertible debenture in the amount of $660,000 which is convertible at a price of $3.00 per share, subject to adjustment under certain conditions. The terms of the debenture provides, absent shareholder approval, that the number of shares of our common stock that may be issued to or acquired by the Estate of Mr. McElroy upon conversion of any debenture shall not exceed 19.99% of the total number of issued and outstanding shares of our common stock.

(12) Includes 305,482 shares of common stock held by Burlingame Equity Investors, LP, 42,194 shares of common stock held by Burlingame Equity Investors II, LP, and 112,547 shares of common stock held by Burlingame Equity Investors (Offshore) Ltd. Mr. Blair Sanford is the managing member of Burlingame Asset Management LLC, which is the general partner of Burlingame Equity Investors, LP, Burlingame Equity Investors II, LP, and Burlingame Equity Investors (Offshore) Ltd.

(13) These percentages exclude treasury shares in the calculation of percentage of class.

We are not aware of any arrangements that could result in a change of control.

(2) TO APPROVE AN AMENDMENT TO THE ARTICLES OF INCORPORATION TO INCREASE THE NUMBER OF AUTHORIZED SHARES OF COMMON STOCK FROM 15,000,000 TO 20,000,000

Our Stockholders are being asked to approve an amendment to the Corporation's Articles of Incorporation to increase the number of authorized shares of the Corporation's common stock from 15,000,000 to 20,000,000.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT THE STOCKHOLDERS PLACE A VOTE "FOR" PROPOSAL "2", AND YOUR PROXY WILL BE SO VOTED UNLESS YOU SPECIFY OTHERWISE.

Voting Rights with Respect to the Increase in Authorized Shares

The Board is of the opinion that the amendment to the Articles of Incorporation to Increase the Authorized Shares of Common Stock is advisable and in the Corporation's best interests and recommends a vote "FOR" the approval this proposal. The form of Certificate of Amendment to the Articles of Incorporation is attached hereto as Exhibit "B". The affirmative vote of a majority of the issued and outstanding shares of Common Stock is required for the approval of the amendment to the Articles of Incorporation to increase the authorized shares of Common Stock. For purposes of the vote to amend the Articles of Incorporation to increase the authorized shares of Common Stock, as amended, abstentions and broker non-votes will have the same effect as a vote against this proposal. All proxies will be voted to approve the amendment to the Articles of Incorporation unless a contrary vote is indicated on the enclosed proxy card.

Proposal to Increase Authorized Common Stock

The Board has approved, subject to stockholder approval, an amendment to our Articles of Incorporation, as amended, which will increase the aggregate number of shares of common stock authorized for issuance from 15,000,000 shares to 20,000,000 shares.

The proposed increase in the authorized Common Stock has been recommended by the Board to assure that an adequate supply of authorized unissued shares is available for use primarily in connection with corporate acquisitions. The shares may also be used for general corporate needs, such as future stock dividends or stock splits. There currently are no plans or arrangements relating to the issuance of any of the additional shares of Common Stock proposed to be authorized.

General

Our authorized capital stock currently consists of 16,000,000 shares of which there are 15,000,000 shares of common stock, par value $.01 per share, and 1,000,000 shares of preferred stock, par value $.10 per share.

As of June 27, 2008, there were 8,825,447 shares of common stock outstanding. The rights of all holders of the common stock are identical in all respects. The holders of the common stock are entitled to receive ratably such dividends, if any, as may be declared by the Board of Directors out of legally available funds. The current policy of the Board of Directors, however, is to retain earnings, if any, for reinvestment. Upon liquidation, dissolution or winding up of the Company, the holders of the common stock are entitled to share ratably in all aspects of the Company that are legally available for distribution, after payment of or provision for all debts and liabilities. The holders of the common stock do not have preemptive subscription, redemption or conversion rights under our Articles of Incorporation. Cumulative voting in the election of Directors is not permitted. The outstanding shares of common stock are validly issued, fully paid and nonassessable. The rights, preferences and privileges of holders of common stock will be subject to, and may be adversely affected by, the rights of holders of shares of any series of preferred stock that are presently outstanding or that may be designated and issued by us in the future. If the Proposal is adopted, the first full paragraph of Article Four of the Corporation's Articles of Incorporation, as amended, will read as follows:

"ARTICLE FOUR"

"The aggregate number of shares of all classes of stock which the Corporation shall have authority to issue is 21,000,000 consisting of and divided into the following classes:

(i) Twenty Million (20,000,000) shares of common stock, par value $.01 per share (hereinafter designated the "Common Stock"); and

(ii) One Million (1,000,000) shares of preferred stock, par value $0.01 per share (hereinafter designated the "Preferred Stock")."

CERTAIN EFFECTS OF THE PROPOSED AMENDMENT

The Board believes that approval of this Proposal is essential for the growth and development of the Corporation. However, the following should be considered by a stockholder in deciding how to vote upon this Proposal.

The additional shares that the Board would be authorized to issue upon approval of the Proposal, if so issued, would have a dilutive effect upon the percentage of the Corporation's equity owned by present stockholders. The issuance of the additional shares might be disadvantageous to current stockholders in that any additional issuances would potentially reduce per share dividends, if any. Stockholders should consider, however, that the possible impact upon dividends is likely to be minimal in view of the fact that the Corporation has never paid dividends on shares of the Corporation's Common Stock and do not have any current plans to pay a cash dividend in the foreseeable future, except to the extent we would be required to satisfy any obligations with respect to any Preferred Stock we may issue in the future. The Corporation presently intends to retain earnings, for investment and use in business operations.

EFFECTIVENESS OF THE AUTHORIZED INCREASE

If the Authorized Share Increase Amendment is approved by the requisite vote of the Corporation's stockholders, the Authorized Share Increase will be effective upon the close of business on the date of filing of the Authorized Share Increase Amendment with the Texas Secretary of State, which filing is expected to take place shortly after the Stockholder Meeting. If this Proposal is not approved by the stockholders, then the Authorized Share Increase Amendment will not be filed.

(3) TO RATIFY THE SELECTION OF WHITLEY PENN LLP
AS THE COMPANY'S INDEPENDENT REGISTERED
PUBLIC ACCOUNTING FIRM
FOR THE FISCAL YEAR ENDING
SEPTEMBER 30, 2008

The Board of Directors has selected Whitley Penn LLP as the Company's independent registered public accounting firm for the current fiscal year. Although not required by law or otherwise, the selection is being submitted to the Stockholders of the Company as a matter of corporate policy for their approval. The Board of Directors wishes to obtain from the Stockholders a ratification of their action in appointing their existing independent registered public accounting firm, Whitley Penn LLP for the fiscal year ending September 30, 2008. Such ratification requires the affirmative vote of a majority of the shares of Common Stock present or represented by proxy and entitled to vote at the Annual Meeting.

In the event the appointment of Whitley Penn LLP as the Company’s independent registered public accounting firm is not ratified by the Stockholders, the adverse vote will be considered as a direction to the Board of Directors to select another independent registered public accounting firm for the fiscal year ending September 30, 2008. A representative of Whitley Penn LLP is expected to be present at the Annual Meeting with the opportunity to make a statement if he so desires and to respond to appropriate questions. The Board of Directors unanimously recommends a vote FOR the ratification of Whitley Penn LLP as the Company’s independent registered public accounting firm for fiscal year ending September 30, 2008.

The following table sets forth the aggregate fees paid or accrued for professional services rendered by Whitley Penn LLP for the audit of our annual financial statements for fiscal year 2007 and fiscal year 2006 and the aggregate fees paid or accrued for audit-related services and all other services rendered by Whitley Penn LLP for fiscal year 2007 and fiscal year 2006.

	2007	2006
Audit fees	$ 170,208	$ 97,768
Audit-related fees	13,070	16,210
Tax fees	30,170	3,850
All other fees	-	-
Total	$ 213,448	$ 117,828

The category of “Audit fees” includes fees for our annual audit, quarterly reviews and services rendered in connection with regulatory filings with the SEC, such as the issuance of comfort letters and consents.

The category of “Audit-related fees” includes employee benefit plan audits, internal control reviews and accounting consultation.

The category of “Tax fees” includes consultation related to corporate development activities.

All above audit services, audit-related services and tax services were pre-approved by the Audit Committee, which concluded that the provision of such services by Whitley Penn LLP was compatible with the maintenance of that firm’s independence in the conduct of its auditing functions. The Audit Committee’s outside auditor independence policy provides for pre-approval of all services performed by the outside auditors.

AUDITOR INDEPENDENCE

Our Audit Committee considered that the work done for us in fiscal 2007 by Whitley Penn was compatible with maintaining Whitley Penn's independence.

AUDITOR'S TIME ON TASK

All of the work expended by Whitley Penn on our fiscal 2007 audit was attributed to work performed by Whitley Penn's full-time, permanent employees.

---

(4)
OTHER MATTERS

The Board of Directors is not aware of any other matters to be presented for action at the Annual Meeting. However, if any other matter is properly presented at the Annual Meeting, it is the intention of the persons named in the enclosed proxy to vote in accordance with their best judgment on such matters.

FUTURE PROPOSALS OF STOCKHOLDERS

The deadline for stockholders to submit proposals to be considered for inclusion in the Proxy Statement for the 2008 Annual Meeting of Stockholders is April 23, 2009.

BY ORDER OF THE BOARD OF DIRECTORS

/S/ ERIC S. LANGAN
CHAIRMAN OF THE BOARD AND PRESIDENT

JULY 21, 2008
HOUSTON, TEXAS

16

EXHIBIT “A”

RICK'S CABARET INTERNATIONAL, INC.

CHARTER OF THE AUDIT COMMITTEE
OF THE BOARD OF DIRECTORS

1. Purpose. The Audit Committee of the Board of Directors shall conduct continuing oversight of the financial affairs of Rick's Cabaret International, Inc.

2. Scope of Review. The Audit Committee shall conduct an ongoing review the Corporation's:

* Financial reports and other financial information prior to their being filed with the U.S. Securities and Exchange Commission or otherwise provided to the public.

* Systems, methods and procedures of internal controls in the areas of: financial reporting, audits, treasury operations, corporate finance, managerial, financial and SEC accounting, compliance with law, and ethical conduct.

3. General Tasks. The Audit Committee shall:

* Be objective. A majority of the Audit Committee shall be independent.

* Recommend and encourage improvements in the Corporation's financial affairs.

* Review and assess the work of the Corporation's independent accountant and internal audit department.

* Solicit and encourage comments from the Corporation's independent accountant, financial and senior management, internal audit department and the Board of Directors.

4. Audit Committee Members. The Audit Committee shall consist of one or more Members (the "Members"), a majority of whom are independent Directors. The Board of Directors shall elect the Members annually. Members shall serve until their successors are duly elected and qualified. Unless an Audit Committee Chairperson is elected by the full Board, the Members of the Committee may designate a Chairperson by majority vote of the all Members.

5. The independent members shall be free from any relationship that could conflict with an independent member's independent judgment. Any non-independent member shall exercise judgment as if that member was independent. All Members must be able to read and understand fundamental financial statements, including a balance sheet, income statement, and cash flow statement. At least one member must have past employment experience in finance or accounting, requisite professional certification in accounting, or other comparable experience or background, including a current or past position as a chief executive or financial officer or other senior officer with financial oversight responsibilities.

6. Independence. Independent Director is defined as a director who has:

* Not been employed by the Corporation or its affiliates in the current or past three years.

* Not accepted any compensation from the Corporation or its affiliates in excess of $60,000 during the previous fiscal year (except for board service, retirement plan benefits, or non-discretionary compensation).

* No immediate family member who is, or has been in the past three years, employed by the Corporation or its affiliates as an executive officer.

* Not been a partner, controlling shareholder or an executive officer of any other for-profit entity to which the Corporation made, or from which it received, payments (other than those which arise solely from investments in the Corporation's securities) that exceed five percent of the other entity's consolidated gross revenues for that year, or $200,000, whichever is more, in any of the past three years.

* Not been employed as an executive of another entity where the Corporation's executives serve on the other entity's compensation committee.

7. Meetings. The Audit Committee shall meet at least four times per year, and may meet as frequently as deemed necessary. The Audit Committee shall meet separately in closed meetings at least once each year with management, the director of internal audit and the independent accountant to discuss any matter. The Audit Committee shall select one of its Members each quarter to meet with management, the director of internal audit and the independent accountant for the purposes set forth below.

8. Specific Tasks. The Audit Committee shall:

(a) Assess and, if necessary, update this Charter at least annually.

(b) Review the Corporation's annual, quarterly and other financial statements and any other reports, financial information or other material filed with any governmental body (except for litigation matters in the ordinary course of business) or announced to the public, including the independent accountant's certifications, reports, opinions, or reviews.

(c) Review the regular internal reports to management prepared by the internal audit department and management's response thereto.

(d) Review with management and the independent accountant all Form 10-QSB's prior to the filing or prior to the release of earnings information to the public. The Chairperson of the Audit Committee may represent the entire Audit Committee for the review of the Form 10-QSB.

(e) Recommend to the Board of Directors the selection of the independent accountant for each fiscal year, considering independence and effectiveness, and approve the fees and other compensation to be paid to the independent accountant. On an annual basis, the Audit Committee shall review and discuss with the independent accountant all significant relationships the independent accountant has with the Corporation to determine the accountant's independence.

(f) Review the performance of the independent accountant and approve any proposed discharge of the independent accountant when circumstances warrant.

(g) Periodically consult with the independent accountant, out of the presence of management, about internal controls and the completeness and accuracy of the Corporation's financial statements.

(h) Continually review the integrity of the Corporation's internal and external financial reporting processes. The Audit Committee shall consult with the independent accountant and the internal auditors for this review.

(i) Consider the independent accountant's judgments about the quality and appropriateness of the Corporation's accounting principles in relation to the Corporation's internal and external financial reporting.

(j) Consider and approve, if appropriate, major changes to the Corporation's auditing and accounting principles and practices.

(k) Establish regular and separate systems of reporting to the Audit Committee by each of management, the independent accountant and the internal auditors in connection with the appropriateness and application of accounting principles made in management's preparation of the financial statements.

(l) Following completion of the annual audit, review separately with each of management, the independent accountant and the internal audit department whether any difficulties were encountered during the course of the audit, including any restrictions on the scope of work or access to required information.

(m) Review any disagreement among management and the independent or the internal auditing department in connection with the preparation of the financial statements or the appropriateness and application of accounting principles made in management's preparation of the financial statements.

(n) Review with the independent accountant, the internal audit department and management whether and how changes or improvements in the Corporation's financial or accounting practices, as approved by the Audit Committee, have been implemented. The Audit Committee shall conduct this review promptly after the implementation of the changes or improvements.

(o) Establish a code of corporate compliance with law and a code of ethical conduct, and review the Corporation's implementation and enforcement of these codes.

(p) Review activities, organizational structure, and qualifications of the internal audit department.

(q) Review, with the Corporation's counsel, legal compliance matters including policies regarding trading in the Corporation's securities.

(r) Review, with the Corporation's counsel, any legal matter that could have a material impact on the Corporation's financial statements.

(s) Perform any other activities consistent with this Charter, the Corporation's Articles of Incorporation, By-laws and governing law, as the Audit Committee or the Board of Directors deems necessary or appropriate.

EXHIBIT "B"

[Form of Certificate of Amendment
To the Articles of Incorporation]

CERTIFICATE OF AMENDMENT TO THE
ARTICLES OF INCORPORATION OF
RICK'S CABARET INTERNATIONAL, INC.

I, the undersigned hereby certify that:

Pursuant to the provisions of the Texas Business Corporation Act, the undersigned corporation adopted the following Articles of Amendment to its Articles of Incorporation.

The first paragraph of Article Four of the Articles of Incorporation is amended in its entirety to read:

"ARTICLE FOUR"

"The aggregate number of shares of all classes of stock which the Corporation shall have authority to issue is 21,000,000 consisting of and divided into the following classes:

(i) Twenty Million (20,000,000) shares of common stock, par value $.01 per share (hereinafter designated the "Common Stock"); and

(ii) One Million (1,000,000) shares of preferred stock, par value $0.01 per share (hereinafter designated the "Preferred Stock")."

****

The Board of Directors recommended and consented to this amendment on July 2, 2008. A majority of the shareholders of the corporation voted at a meeting of shareholders to amend the Articles of Incorporation. A total of _______________ shares of common stock voted in favor of the amendment to the Articles of Incorporation, which constituted the vote of a majority of the shares entitled to vote on this amendment. There are no other classes of stock outstanding.

(signed)

by /s/ Eric Langan, CEO/President

STATE OF TEXAS
COUNTY OF HARRIS

BEFORE ME, the undersigned authority, on this day personally appeared Eric Langan, known to me to be the person whose name is subscribed to the foregoing instrument and acknowledged to me that he executed the same for the purposes and consideration therein expressed.

GIVEN UNDER MY HAND AND SEAL of office this _____ day of ______________, 2008.

(signed)

[Notary Seal]

NOTARY PUBLIC IN AND FOR THE
STATE OF TEXAS

My commission expires ________________________

PROXY
RICK'S CABARET INTERNATIONAL, INC.

THIS PROXY IS SOLICITED ON BEHALF OF THE
BOARD OF DIRECTORS FOR THE
ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD ON SEPTEMBER 2, 2008

The undersigned hereby appoints Eric S. Langan and Travis Reese, and each of them as the true and lawful attorneys, agents and proxies of the undersigned, with full power of substitution, to represent and to vote all shares of Common Stock of Rick's Cabaret International, Inc. held of record by the undersigned on June 27, 2008, at the Annual Meeting of Stockholders to be held on Tuesday, September 2, 2008, at 10:00 AM (CST) at 410 N. Sam Houston Parkway (Beltway 8 at Imperial Valley), Houston, Texas 77060, and at any adjournments thereof. Any and all proxies heretofore given are hereby revoked.

WHEN PROPERLY EXECUTED, THIS PROXY WILL BE VOTED AS DESIGNATED BY THE UNDERSIGNED. IF NO CHOICE IS SPECIFIED, THE PROXY WILL BE VOTED FOR THE NOMINEES LISTED IN NUMBER 1, FOR THE APPROVAL IN NUMBER 2, AND FOR THE RATIFICATION IN NUMBER 3.

1. ELECTION OF DIRECTORS OF THE COMPANY. (INSTRUCTION: TO WITHHOLD AUTHORITY TO VOTE FOR ANY INDIVIDUAL NOMINEE, STRIKE A LINE THROUGH, OR OTHERWISE STRIKE, THAT NOMINEE'S NAME IN THE LIST BELOW.)

£ FOR all nominees listed below except as marked to the contrary.	£ WITHHOLD authority to vote for all nominees below.
Eric S. Langan	Alan Bergstrom
Robert L. Watters	Travis Reese
Steven L. Jenkins	Luke Lirot

2. APPROVAL OF AN AMENDMENT TO THE ARTICLES OF INCORPORATION TO INCREASE THENUMBER OF AUTHORIZED SHARES OF THE COMPANY’S COMMON STOCK FROM 15,000,000 TO 20,000,000.

£ FOR £ AGAINST £ ABSTAIN

3. PROPOSAL TO RATIFY THE SELECTION OF WHITLEY PENN LLP AS THE COMPANY'S INDEPENDENT AUDITOR FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 2008.

£ FOR £ AGAINST £ ABSTAIN

4. IN THEIR DISCRETION, THE PROXIES ARE AUTHORIZED TO VOTE UPON SUCH OTHER BUSINESS THAT MAY PROPERLY COME BEFORE THE ANNUAL MEETING.

£ FOR £ AGAINST £ ABSTAIN

Please sign exactly as name appears below. When shares are held by joint tenants, both should sign. When signing as attorney, as executor, administrator, trustee or guardian, please give full title as such. If a corporation, please sign in full corporate name by President or other authorized officer. If a partnership, please sign in partnership name by authorized person.

NUMBER OF
S H A R E S
OWNED

PRINTED NAME:
DATED:

THIS PROXY MAY BE REVOKED AT ANY TIME BEFORE IT IS VOTED AT THE MEETING. PLEASE MARK, SIGN, DATE AND RETURN THIS PROXY PROMPTLY.

Letter to Shareholders of Rick's Cabaret International, Inc.

From: Eric Langan
Chief Executive Officer

Subject: Fiscal 2007 Results

Dear Shareholder,

It seems long ago that Rick's Cabaret began our 2007 fiscal year confident it would be the most successful year in the history of our company. As it turned out, our progress in 2007 exceeded our own expectations. And, we are registering even stronger advances as we move through 2008.

Your company generated revenues of $32 million in the fiscal year ending September 30, 2007 -- a 30.7 percent increase over 2006; net income was $3 million, a 74.3 percent increase over the previous year.

Here are some of the highlights that contributed to the outstanding 2007 performance:

- Our flagship Rick's Cabaret in Midtown Manhattan continued its exceptional growth.
- Our acquisitions in Ft. Worth, San Antonio and Austin began contributing.
- Revenues increased by 11.8 percent year over year from clubs open more than one year.
- Cash flows improved significantly, with net cash provided by operating activities increasing to $4.38 million, compared with $2.73 million in 2006.
- Our balance sheet strengthened, with total assets as of September 30, 2007 at $47 million, compared with $30.60 million at the end of fiscal 2006.
- Our management team continued to strengthen, enabling us to absorb our new acquisitions with few integration problems.

Full fiscal year earnings were 54 cents per basic share in 2007, which exceeded the company's guidance of 48 cents. Earnings per fully diluted share were 50 cents, compared with 35 cents in the previous year.

Revenue from Internet businesses decreased by 9.1 percent in 2007, but web-based activities still generated operating income of $111,919. While only modestly profitable on a standalone basis, our Internet business continues to be a valuable segment of our overall operations because it essentially enables us to have profitable in-house IT and graphics departments that we can call on at any time to meet our overall promotional, marketing and IT needs.

Our company is now being followed by well-respected analysts Eric Wold of Merriman Curhan Ford and James Clement of Sidoti & Company LLC. In addition, buy-side coverage of RICK has been initiated by Singular Research, Montgomery Street Research and Stonegate Securities.

The other exciting story behind the successes your company enjoyed last year is that we build a strong foundation for more growth in 2008. Here are some of the major accomplishments so far:

- Tootsie's Cabaret, our 47,000 sq. ft. adult nightclub in Miami, is contributing over $2 million in revenue and solid profits, each month.
- Our new 25,000 sq. ft. nightclub in Philadelphia is a prize location that that is already considered the finest adult cabaret, steakhouse and sports bar combo in the region.
- We signed definitive documents to acquire the former Scores-Las Vegas cabaret, which will give us a powerful presence in the most popular recreation-leisure destination in the country.
- We acquired two clubs in Dallas -- the former Executive Club in Dallas and the nearby Platinum II club, which will become a Club Onyx. These acquisitions give us three locations in the strong Dallas-Ft. Worth market.
- We continued to report strong comparative same-club growth through the first half of the year, with our midtown Manhattan club again leading the way.
- We acquired ED Publications, providing us with a media platform in adult entertainment industries.

Our success is due to that unique mix of employees and outstanding entertainers who are dedicated to enabling each of our customers to enjoy a great time on their visits to Rick's Cabaret, Club Onyx, XTC Cabaret and Tootsie's Cabaret. We are extremely fortunate to have over 700 outstanding individuals on our staffs and over 3,000 of the best nightclub entertainers in the business. Our management team has been strengthened through our internal training programs and supplemented with people who have come to us through our acquisition of new clubs.

I thank you for your confidence in Rick's Cabaret. Your support makes it possible for us to grow and prosper. We will continue to keep your interests uppermost as we complete transactions and build our brands nationally.

Please feel free to ask me any questions you may have by emailing me at eric@ricks.com, or talk to our investor relations representatives at ir@ricks.com.

Thank you.

/s/ Eric Langan
Eric Langan
President/CEO