
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2017

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 001-13992

RCI HOSPITALITY HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Texas
(State or other jurisdiction of
incorporation or organization)

76-0458229
(I.R.S. Employer
Identification No.)

10737 Cutten Road
Houston, Texas 77066
(Address of principal executive offices) (Zip Code)

(281) 397-6730
(Registrant's telephone number, including area code)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of February 28, 2018, 9,718,711 shares of the registrant's common stock were outstanding.

NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, among other things, statements regarding plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. Forward-looking statements may appear throughout this report, including, without limitation, the following sections: Part I, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements generally can be identified by words such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “will be,” “will continue,” “will likely result,” and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q and those discussed in other documents we file with the Securities and Exchange Commission (“SEC”). Important factors that in our view could cause material adverse effects on our financial condition and results of operations include, but are not limited to, the risks and uncertainties associated with operating and managing an adult business, the business climates in cities where it operates, the success or lack thereof in launching and building the company’s businesses, risks and uncertainties related to cyber security, conditions relevant to real estate transactions, and numerous other factors such as laws governing the operation of adult entertainment businesses, competition and dependence on key personnel. We undertake no obligation to revise or publicly release the results of any revision to any forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

As used herein, the “Company,” “we,” “our,” and similar terms include RCI Hospitality Holdings, Inc. and its subsidiaries, unless the context indicates otherwise.

RCI HOSPITALITY HOLDINGS, INC.
FORM 10-Q
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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

**RCI HOSPITALITY HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value)**

| | December 31, 2017 | September 30, 2017 |
|--|--------------------------|---------------------------|
| | (unaudited) | |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 11,954 | \$ 9,922 |
| Accounts receivable, net | 4,113 | 3,187 |
| Inventories | 2,419 | 2,149 |
| Prepaid insurance | 2,808 | 3,826 |
| Other current assets | 746 | 1,399 |
| Assets held for sale | 5,565 | 5,759 |
| Total current assets | 27,605 | 26,242 |
| Property and equipment, net | 154,259 | 148,410 |
| Notes receivable | 4,965 | 4,993 |
| Goodwill | 43,866 | 43,866 |
| Intangibles, net | 74,420 | 74,424 |
| Other assets | 1,464 | 1,949 |
| Total assets | \$ 306,579 | \$ 299,884 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 2,601 | \$ 2,147 |
| Accrued liabilities | 11,584 | 11,524 |
| Current portion of long-term debt | 14,048 | 17,440 |
| Total current liabilities | 28,233 | 31,111 |
| Deferred tax liability, net | 15,844 | 25,541 |
| Long-term debt | 111,944 | 106,912 |
| Other long-term liabilities | 1,324 | 1,095 |
| Total liabilities | 157,345 | 164,659 |
| Commitments and contingencies (Note 8) | | |
| Stockholders' equity | | |
| Preferred stock, \$0.10 par value per share; 1,000 shares authorized; none issued and outstanding | - | - |
| Common stock, \$0.01 par value per share; 20,000 shares authorized; 9,719 and 9,719 shares issued and outstanding as of December 31, 2017 and September 30, 2017, respectively | 97 | 97 |
| Additional paid-in capital | 63,453 | 63,453 |
| Retained earnings | 83,214 | 69,195 |
| Total RCIHH stockholders' equity | 146,764 | 132,745 |
| Noncontrolling interests | 2,470 | 2,480 |
| Total stockholders' equity | 149,234 | 135,225 |
| Total liabilities and stockholders' equity | \$ 306,579 | \$ 299,884 |

See accompanying notes to condensed consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)
(unaudited)

| | For the Three Months Ended December 31, | |
|---|--|-----------------|
| | 2017 | 2016 |
| Revenues | | |
| Sales of alcoholic beverages | \$ 17,805 | \$ 14,375 |
| Sales of food and merchandise | 5,307 | 4,207 |
| Service revenues | 15,889 | 13,475 |
| Other | 2,211 | 1,682 |
| Total revenues | <u>41,212</u> | <u>33,739</u> |
| Operating expenses | | |
| Cost of goods sold | | |
| Alcoholic beverages sold | 3,755 | 3,168 |
| Food and merchandise sold | 2,094 | 1,653 |
| Service and other | 36 | 60 |
| Cost of goods sold (exclusive of items shown separately below) | 5,885 | 4,881 |
| Salaries and wages | 11,377 | 9,652 |
| Selling, general and administrative | 12,812 | 11,193 |
| Depreciation and amortization | 1,909 | 1,618 |
| Other charges, net | 89 | 62 |
| Total operating expenses | <u>32,072</u> | <u>27,406</u> |
| Income from operations | 9,140 | 6,333 |
| Other income (expenses) | | |
| Interest expense | (3,079) | (2,015) |
| Interest income | 67 | 37 |
| Income before income taxes | 6,128 | 4,355 |
| Income tax expense (benefit) | (8,227) | 1,450 |
| Net income | 14,355 | 2,905 |
| Net income attributable to noncontrolling interests | (44) | (7) |
| Net income attributable to RCIHH common shareholders | <u>\$ 14,311</u> | <u>\$ 2,898</u> |
| Earnings per share attributable to RCIHH common shareholders | | |
| Basic | \$ 1.47 | \$ 0.30 |
| Diluted | \$ 1.47 | \$ 0.30 |
| Weighted average number of common shares outstanding | | |
| Basic | 9,719 | 9,768 |
| Diluted | 9,719 | 9,814 |
| Dividend per share | \$ 0.03 | \$ 0.03 |

See accompanying notes to condensed consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

| | For the Three Months Ended December 31, | |
|---|--|------------------|
| | 2017 | 2016 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 14,355 | \$ 2,905 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,909 | 1,618 |
| Deferred taxes | (9,697) | - |
| Amortization of debt discount and issuance costs | 324 | 85 |
| Deferred rent | 75 | 40 |
| Loss on sale of assets | 140 | - |
| Gain on insurance settlements | (20) | - |
| Debt prepayment penalty | 543 | - |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (926) | 644 |
| Inventories | (270) | (87) |
| Prepaid expenses and other assets | 1,044 | 588 |
| Accounts payable and accrued liabilities | 668 | (272) |
| Net cash provided by operating activities | <u>8,145</u> | <u>5,521</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from sale of assets | 632 | - |
| Proceeds from insurance | 20 | - |
| Proceeds from notes receivable | 28 | 20 |
| Additions to property and equipment | (2,769) | (3,008) |
| Net cash used in investing activities | <u>(2,089)</u> | <u>(2,988)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from long-term debt | 58,920 | 1,900 |
| Payments on long-term debt | (61,256) | (2,152) |
| Debt prepayment penalty | (543) | - |
| Purchase of treasury stock | - | (1,101) |
| Payment of dividends | (292) | (290) |
| Payment of loan origination costs | (799) | (99) |
| Distribution to noncontrolling interests | (54) | (54) |
| Net cash used in financing activities | <u>(4,024)</u> | <u>(1,796)</u> |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 2,032 | 737 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 9,922 | 11,327 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | <u>\$ 11,954</u> | <u>\$ 12,064</u> |
| CASH PAID DURING PERIOD FOR: | | |
| Interest | \$ 2,890 | \$ 1,920 |
| Income taxes | \$ 157 | \$ 385 |

See accompanying notes to condensed consolidated financial statements.

Non-cash and other transactions:

During the quarter ended December 31, 2017, the Company refinanced \$81.2 million of long-term debt comprised of 21 notes payable with the execution of three notes payable with a lender bank. The new notes and the repaid balance included \$18.7 million worth of debt with the same lender bank. See Note 4 for a detailed discussion of the refinancing.

During the quarter ended December 31, 2017, the Company borrowed \$7.1 million from a lender to purchase an aircraft by trading in an aircraft that the Company owned and the assumption of the old aircraft's note payable liability. See Note 4 for a detailed discussion of the transaction.

During the quarter ended December 31, 2016, the Company refinanced \$8.0 million of long-term debt by borrowing \$9.9 million, resulting in net cash proceeds of \$1.9 million.

During the quarter ended December 31, 2016, the Company purchased and retired 89,685 common shares at a cost of \$1.1 million.

RCI HOSPITALITY HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP” or “US GAAP”) for interim financial information and with the instructions to Form 10-Q of Regulation S-X. They do not include all information and footnotes required by GAAP for complete financial statements. The September 30, 2017 consolidated balance sheet data were derived from audited financial statements but do not include all disclosures required by GAAP. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to the consolidated financial statements for the year ended September 30, 2017 included in the Company’s Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on February 14, 2018. The interim unaudited condensed consolidated financial statements should be read in conjunction with those consolidated financial statements included in the Form 10-K. In the opinion of management, all adjustments considered necessary for a fair presentation of the financial statements, consisting solely of normal recurring adjustments, have been made. Operating results for the three months ended December 31, 2017 are not necessarily indicative of the results that may be expected for the year ending September 30, 2018.

2. Recent Accounting Standards and Pronouncements

In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”), which supersedes nearly all existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing GAAP. The standard’s effective date has been deferred by the issuance of ASU No. 2015-14, and is effective for annual periods beginning after December 15, 2017, and interim periods therein. The guidance permits using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). Early application is permitted but not before December 15, 2016, the ASU’s original effective date. The Company is still evaluating the impact of the standard and which transition method it is going to use upon adoption.

In July 2015, the FASB issued ASU No. 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*. This ASU does not apply to inventory that is measured using last-in, first-out (“LIFO”) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using FIFO or average cost. This ASU eliminates from U.S. GAAP the requirement to measure inventory at the lower of cost or market. Market under the previous requirement could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. Entities within scope of this update will now be required to measure inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory using LIFO or the retail inventory method. The amendments in this update are effective for fiscal years beginning after December 15, 2016, with early adoption permitted, and should be applied prospectively. The Company adopted ASU 2015-11 as of October 1, 2017, which did not have an impact on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, on accounting for leases which requires lessees to recognize most leases on their balance sheets for the rights and obligations created by those leases. The guidance requires enhanced disclosures regarding the amount, timing, and uncertainty of cash flows arising from leases, and will be effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. The guidance requires the use of a modified retrospective approach. We expect our consolidated balance sheets to be materially impacted upon adoption due to the recognition of right-of-use assets and lease liabilities related to currently classified operating leases. We do not expect ASU 2016-02 to have a material impact on our consolidated statements of income though we expect a shift in the classification of expenses, the materiality of which we are currently evaluating.

RCI HOSPITALITY HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

In January 2017, the FASB issued ASU No. 2017-01, *Business Combination (Topic 805): Clarifying the Definition of a Business*. According to the guidance, when substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets), the assets acquired would not represent a business. If met, this initial screen eliminates the need for further assessment. To be considered a business, an acquisition would have to include an input and a substantive process that together significantly contribute to the ability to create outputs. ASU 2017-01 provides a framework to evaluate when an input and a substantive process are present. To be a business without outputs, there will now need to be an organized workforce. The FASB noted that outputs are a key element of a business and included more stringent criteria for aggregated sets of assets and activities without outputs. Finally, the guidance narrows the definition of the term “outputs” to be consistent with how it is described in Topic 606, *Revenue from Contracts with Customers*. Under the final definition, an output is the result of inputs and substantive processes that provide goods and services to customers, other revenue, or investment income, such as dividends and interest. The standard is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The amendments can be applied to transactions occurring before the guidance was issued as long as the applicable financial statements have not been issued. We have early adopted ASU 2017-01 as of October 1, 2017, and will apply its amendments to future transactions.

In May 2017, the FASB issued ASU No. 2017-09, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting*. The amendments of this ASU provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless all of the following are met: (1) the fair value of the modified award is the same as the fair value of the original award immediately before the modification; (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the modification; and (3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the modification. The current disclosure requirements in Topic 718 are not changed. The amendments in this ASU are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017, with early adoption permitted. Since March 31, 2017, we do not have any stock-based compensation awards outstanding. We have early adopted ASU 2017-09 as of October 1, 2017, and will apply its provisions to future stock compensation awards and transactions.

3. Selected Account Information

The components of accrued liabilities are as follows (in thousands):

| | December 31, 2017 | September 30, 2017 |
|---------------------------|--------------------------|---------------------------|
| Insurance | \$ 2,173 | \$ 3,160 |
| Payroll and related costs | 2,375 | 1,889 |
| Income taxes | 1,862 | 549 |
| Property taxes | 1,361 | 1,270 |
| Sales and liquor taxes | 1,000 | 990 |
| Patron tax | 834 | 801 |
| Unearned revenues | 454 | 196 |
| Lawsuit settlement | 37 | 295 |
| Other | 1,488 | 2,374 |
| | <u>\$ 11,584</u> | <u>\$ 11,524</u> |

The components of selling, general and administrative expenses are as follows (in thousands):

| | For the Three Months Ended December 31, | |
|----------------------------------|--|------------------|
| | 2017 | 2016 |
| Taxes and permits | \$ 2,166 | \$ 2,289 |
| Advertising and marketing | 1,965 | 1,657 |
| Supplies and services | 1,368 | 1,146 |
| Insurance | 1,259 | 935 |
| Rent | 940 | 690 |
| Charge card fees | 887 | 570 |
| Accounting and professional fees | 886 | 497 |
| Utilities | 695 | 670 |
| Security | 638 | 541 |
| Repairs and maintenance | 570 | 466 |
| Legal | 377 | 703 |
| Other | 1,061 | 1,029 |
| | <u>\$ 12,812</u> | <u>\$ 11,193</u> |

RCI HOSPITALITY HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

4. Long-Term Debt

Long-term debt consisted of the following (in thousands):

| | <u>December 31, 2017</u> | <u>September 30, 2017</u> |
|---|--------------------------|---------------------------|
| Notes payable at 10-11%, mature August 2022 and December 2024 | \$ - | \$ 2,358 |
| Note payable at 7%, matures December 2019 | - | 95 |
| Notes payable at 5.5%, matures January 2023 | 1,136 | 1,157 |
| Notes payable at 5.5%, matures January 2023 and January 2022 | - | 4,510 |
| Note payable refinanced at 6.25%, matures July 2018 | - | 1,120 |
| Note payable at 9.5%, matures August 2024 | - | 6,941 |
| Notes payable at 9.5%, mature September 2024 | - | 6,423 |
| Notes payable at 5-7%, mature from 2018 to 2028 | - | 1,679 |
| 7.45% note payable, matures January 2019 | - | 2,740 |
| Non-interest-bearing debt to State of Texas, matures May 2022, interest imputed at 9.6% | 5,365 | 5,613 |
| Note payable at 6.5%, matures January 2020 | - | 4,484 |
| Note payable at 6%, matures January 2019 | - | 504 |
| Notes payable at 5.5%, matures May 2020 | - | 5,320 |
| Note payable at 6%, matures May 2020 | - | 1,037 |
| Note payable at 5.25%, matures December 2024 | - | 1,777 |
| Note payable initially at 5.45%, matures July 2020 (amended to December 2027 with refinancing) | 10,536 | 10,620 |
| Note payable at the greater of 2% above prime or 5% (6.25% at September 30, 2017), matures October 2025 | - | 4,303 |
| Note payable at 5%, matures January 2026 | - | 9,672 |
| Note payable at 5.25%, matures March 2037 | - | 4,651 |
| Note payable at 6.25%, matures February 2018 | 1,894 | 1,894 |
| Note payable initially at 5.95%, matures August 2021 (amended to December 2027 with refinancing) | 8,095 | 8,267 |
| Note payable at 12%, matures October 2021 | 6,704 | 9,671 |
| Note payable at 4.99%, matures April 2037 | 934 | 941 |
| Notes payable at 12%, mature May 2020 | 5,440 | 5,440 |
| Note payable at 5%, matures November 2017 | 3,025 | 5,000 |
| Note payable at 8%, matures May 2029 | 15,090 | 15,291 |
| Note payable at 5%, matures May 2038 | 4,456 | 3,441 |
| Note payable initially at 5.75%, matures December 2027 | 57,904 | - |
| Note payable at 5.95%, matures December 2032 | 7,098 | - |
| Total debt | 127,677 | 129,949 |
| Less unamortized debt issuance costs | (1,685) | (597) |
| Less current portion | (14,048) | (17,440) |
| Total long-term debt | <u>\$ 111,944</u> | <u>\$ 106,912</u> |

RCI HOSPITALITY HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

On December 14, 2017, the Company entered into a loan agreement (“New Loan”) with a bank for \$81.2 million. The New Loan fully refinances 20 of the Company’s notes payable and partially pays down 1 note payable (collectively, “Repaid Notes”) with interest rates ranging from 5% to 12% covering 43 parcels of real properties the Company previously acquired (“Properties”). The New Loan consists of three promissory notes:

- (i) The first note amounts to \$62.5 million with a term of 10 years at a 5.75% fixed interest rate for the first five years, then repriced one time at the then current U.S. Treasury rate plus 3.5%, with a floor rate of 5.75%, and payable in monthly installments of \$442,058, based upon a 20-year amortization period, with the balance payable at maturity;
- (ii) The second note amounts to \$10.6 million with a term of 10 years at a 5.45% fixed interest rate until July 2020, after which to be repriced at a fixed interest rate of 5.75% until the fifth anniversary of this note, and then to be repriced again at the then interest rate of the first note. This note is payable \$78,098 monthly for principal and interest until July 2020, based upon a 20-year amortization period, after which the monthly payment for principal and interest is adjusted accordingly based on the repricing, with the balance payable at maturity; and
- (iii) The third note amounts to \$8.1 million with a term of 10 years at a 5.95% fixed interest rate until August 2021, after which to be repriced at 5.75% until the fifth anniversary of this note, and then to be repriced again at the then interest of the first note. This note is payable \$100,062 monthly for principal and interest until August 2021, based upon a 20-year amortization period, after which the monthly payment for principal and interest is adjusted accordingly based on the repricing, with the balance payable at maturity.

In addition to the monthly principal and interest payments as provided above, the Company will pay monthly installments of principal of \$250,000, applied to the first note, until such time as the loan-to-value ratio of the Properties, based upon reduced principal balance of the New Loan and the then current value of the Properties, is not greater than 65%. The New Loan has eliminated balloon payments of the Repaid Notes worth \$2.9 million originally scheduled in fiscal 2018, \$19.4 million originally scheduled in fiscal 2020 and \$5.3 million originally scheduled in fiscal 2021.

In connection with the Repaid Notes, we wrote off \$279,000 of unamortized debt issuance costs to interest expense. Prior to September 30, 2017, the Company paid a portion of debt issuance costs amounting to \$612,500, which was included in other assets until the closing of the transaction. At closing, the Company paid an additional \$764,000 in debt issuance costs, which together with the \$612,500 prepayment will be amortized for the term of the loan using the effective interest rate method. We also paid prepayment penalties amounting to \$543,000 on the Repaid Notes.

Included in the \$62.5 million note detailed in (i) above, was \$4.6 million that was escrowed and due to the bank lender of one of the Repaid Notes. The amount will be released from escrow when the construction, for which the original note was borrowed, is completed.

In December 2017, the Company borrowed \$7.1 million from a lender to purchase an aircraft at 5.95% interest. The transaction was partly funded by trading in an aircraft that the Company owned with a carrying value of \$3.4 million with an assumption of the old aircraft’s note payable liability of \$2.0 million. The note is payable in 15 years with monthly payments of \$59,869, which includes interest.

As of December 31, 2017, the Company is in compliance with all its debt covenants.

RCI HOSPITALITY HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Future maturities of long-term debt consist of the following (in thousands) as of December 31, 2017:

| 12-Month Period Ending | Regular Amortization | Balloon Payments | Total Payments |
|-------------------------------|---------------------------------|-----------------------------|---------------------------|
| December 31, 2018 | \$ 9,129 | \$ 4,919 | \$ 14,048 |
| December 31, 2019 | 9,289 | - | 9,289 |
| December 31, 2020 | 7,381 | 5,440 | 12,821 |
| December 31, 2021 | 7,707 | - | 7,707 |
| December 31, 2022 | 6,587 | 3,779 | 10,366 |
| Thereafter | 16,928 | 56,518 | 73,446 |
| | <u>\$ 57,021</u> | <u>\$ 70,656</u> | <u>\$ 127,677</u> |

On February 15, 2018, the Company borrowed \$3.0 million from a bank for the purchase of land at a cost of \$4.0 million with the difference paid by the Company in cash. The bank note bears interest at 5.25% adjusted after 36 months to prime plus 1% with a floor of 5.2% and matures on February 15, 2038. The bank note is payable interest-only during the first 18 months, after which monthly payments of principal and interest will be made based on a 20-year amortization with the remaining balance to be paid at maturity.

On February 20, 2018, the Company refinanced a bank note with a balance of \$1.9 million, bearing interest of 2% over prime with a 5.5% floor, with the same bank for a construction loan with maximum availability of \$4.7 million. The construction loan agreement bears an interest rate of prime plus 0.5% with a floor of 5.0% and matures on August 20, 2029. During the first 18 months of the construction loan, the Company will make monthly interest-only payments, and after such, monthly payments of principal and interest will be made based on a 20-year amortization with the remaining balance to be paid at maturity.

5. Stockholders' Equity

During the quarter ended December 31, 2017, the Company did not purchase shares of its common stock. The Company also paid a \$0.03 per share cash dividend totaling approximately \$292,000.

During the quarter ended December 31, 2016, the Company purchased and retired 89,685 common shares at a cost of \$1.1 million. The Company also paid a \$0.03 per share cash dividend totaling approximately \$290,000.

6. Earnings Per Share

Basic earnings per share ("EPS") includes no dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of the Company. Potential common stock shares consist of shares that may arise from outstanding dilutive common restricted stock, stock options and warrants (the number of which is computed using the "treasury stock method") and from outstanding convertible debentures (the number of which is computed using the "if converted method"). Diluted EPS considers the potential dilution that could occur if the Company's outstanding common restricted stock, stock options, warrants and convertible debentures were converted into common stock that then shared in the Company's earnings (as adjusted for interest expense that would no longer occur if the debentures were converted).

The table below presents the reconciliation of the numerator and the denominator in the calculation of basic and diluted EPS (in thousands, except per share amounts):

| | For the Three Months Ended December 31, | |
|---|--|-----------------|
| | 2017 | 2016 |
| Numerator - | | |
| Net income attributable to RCIHH common shareholders – basic | \$ 14,311 | \$ 2,898 |
| Adjustment to net income from assumed conversion of debentures(2) | - | 5 |
| Adjusted net income attributable to RCIHH common shareholders – diluted | <u>\$ 14,311</u> | <u>\$ 2,903</u> |
| Denominator(1)(3)- | | |
| Weighted average number of common shares outstanding – basic | 9,719 | 9,768 |
| Effect of potentially dilutive convertible debentures(2) | - | 46 |
| Adjusted weighted average number of common shares outstanding – diluted | <u>9,719</u> | <u>9,814</u> |
| Basic earnings per share | \$ 1.47 | \$ 0.30 |
| Diluted earnings per share | \$ 1.47 | \$ 0.30 |

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- (1) There were no outstanding restricted stock, warrants and options during the three months ended December 31, 2017 and 2016.
- (2) Convertible debentures (principal and accrued interest) outstanding at the beginning of the quarters ended December 31, 2017 and 2016 totaling \$0 and \$859,000, respectively, were convertible into common stock at a price of \$10.25 and \$12.50 per share until January 4, 2017, when the last conversion option expired in relation to the payment of the last convertible note.
- (3) Since January 4, 2017 to date, the Company has no outstanding convertible debt.

7. Income Taxes

Income taxes were a benefit of \$8.2 million for the first quarter of 2018 compared to an expense of \$1.5 million for the same quarter of 2017. The effective income tax rate for the first quarter of 2018 was a benefit of 134.3% compared with an expense of 33.3% for the comparable period of 2017. Our effective tax rate is affected by state taxes, permanent differences, and tax credits, including the FICA tip credit, for both years while the first quarter of 2018 was significantly impacted by a \$9.7 million reduction of our deferred tax liability caused by newly enacted tax laws.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Act") was enacted into law. The Act amends the Internal Revenue Code to reduce tax rates and modify policies, credits, and deductions for individuals and businesses. For businesses, the Act reduces the corporate federal tax rate from a maximum of 35% to a flat 21% rate. The corporate tax rate reduction was effective January 1, 2018. Because the Company has a fiscal year end of September 30, the reduced corporate tax rate will result in the application of a blended federal statutory tax rate for its fiscal year 2018 and then a flat 21% thereafter.

Under generally accepted accounting principles, the Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. At September 30, 2017, the Company's deferred tax assets and liabilities were determined based on the then-current enacted federal tax rate of 35%. As a result of the reduction in the corporate income tax rate under the Act, the Company revalued its deferred tax assets and liabilities at December 31, 2017. Deferred tax assets and liabilities expected to be realized in fiscal year 2018 were re-measured using the aforementioned blended rate. All remaining deferred tax assets and liabilities were re-measured using the new statutory federal rate of 21%. These re-measurements collectively resulted in a discrete tax benefit of \$9.7 million that was recognized during the three months ended December 31, 2017. The Company's revaluation of its deferred tax assets and liabilities is subject to further clarification of the Act and refinements of its estimates. As a result, the actual impact on the deferred tax assets and liabilities and income tax expense due to the Act may vary from the amounts estimated.

The Company or one of its subsidiaries files income tax returns for U.S. federal jurisdiction and various states. The Company is no longer subject to federal, state and local income tax examinations by tax authorities for years before 2013. The Company's federal income tax returns for the fiscal years ended September 30, 2015, 2014 and 2013 are currently under examination by the Internal Revenue Service.

The Company accounts for uncertain tax positions pursuant to ASC Topic 740, *Income Taxes*. As of December 31, 2017 and September 30, 2017, the liability for uncertain tax positions totaled approximately \$865,000 in each period, which is included in current liabilities on our condensed consolidated balance sheets. The Company recognizes interest accrued related to uncertain tax positions in interest expense and penalties in operating expenses.

On December 22, 2017, the SEC issued Staff Accounting Bulletin No. 18 ("SAB 118"), which provides guidance on accounting for the tax effects of the Tax Cuts and Jobs Act. In accordance with SAB 118, the Company has made reasonable estimates related to the following areas impacted by the Act: existing timing differences, reversal of existing timing differences, and accelerated depreciation. As such, the Company has left the measurement period open as of December 31, 2017.

8. Commitments and Contingencies

Legal Matters

New York Settlement

Filed in 2009, the case claimed Rick's Cabaret New York misclassified entertainers as independent contractors. Plaintiffs sought minimum wage for the hours they danced and return of certain fees. RCI Entertainment (New York), Inc. and Peregrine Enterprises, Inc. maintained the dancers were properly classified, and alternatively, amounts earned were well in excess of the minimum wage and should satisfy any obligations.

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On April 1, 2015, we and our subsidiaries, RCI Entertainment (New York), Inc. and Peregrine Enterprises, Inc., entered into an agreement to settle in full a New York based federal wage and hour class and collective action filed in the United States District Court for the Southern District of New York. On September 22, 2015, the Court granted final approval of the settlement. Under the terms of the agreement, Peregrine Enterprises, Inc. was to make up to \$15.0 million available to class members and their attorneys. The actual amount paid was determined based on the number of class members responding by the end of a two-month notice period which ended on December 4, 2015. Unclaimed checks or payments reverted back to Peregrine at that time. Based on the current schedule, an initial payment for attorneys' fees of \$1,833,333 was made in October 2015, with two subsequent payments of \$1,833,333 each being made in equal annual installments. As part of the settlement, RCIHH was required to guarantee the obligations of RCI Entertainment (New York), Inc. and Peregrine Enterprises, Inc. under the settlement.

Indemnity Insurance Corporation

As previously reported, the Company and its subsidiaries were insured under a liability policy issued by Indemnity Insurance Corporation, RRG ("IIC") through October 25, 2013. The Company and its subsidiaries changed insurance companies on that date.

On November 7, 2013, the Court of Chancery of the State of Delaware entered a Rehabilitation and Injunction Order ("Rehabilitation Order"), which declared IIC impaired, insolvent and in an unsafe condition and placed IIC under the supervision of the Insurance Commissioner of the State of Delaware ("Commissioner") in her capacity as receiver ("Receiver"). The Rehabilitation Order empowered the Commissioner to rehabilitate IIC through a variety of means, including gathering assets and marshaling those assets as necessary. Further, the order stayed or abated pending lawsuits involving IIC as the insurer until May 6, 2014.

On April 10, 2014, the Court of Chancery of the State of Delaware entered a Liquidation and Injunction Order With Bar Date ("Liquidation Order"), which ordered the liquidation of IIC and terminated all insurance policies or contracts of insurance issued by IIC. The Liquidation Order further ordered that all claims against IIC must be filed with the Receiver before the close of business on January 16, 2015 and that all pending lawsuits involving IIC as the insurer are further stayed or abated until October 7, 2014. As a result, the Company and its subsidiaries no longer have insurance coverage under the liability policy with IIC. Currently, there are several civil lawsuits pending against the Company and its subsidiaries. The Company has retained counsel to defend against and evaluate these claims and lawsuits. We are funding 100% of the costs of litigation and will seek reimbursement from the bankruptcy receiver. The Company filed the appropriate claims against IIC with the Receiver before the January 16, 2015 deadline and has provided updates as requested; however, there are no assurances of any recovery from these claims. It is unknown at this time what effect this uncertainty will have on the Company. As previously stated, since October 25, 2013, the Company has obtained general liability coverage from other insurers, which have covered and/or will cover any claims arising from actions after that date. We have 8 unresolved cases left out of the original 71 cases.

General

The Company has been sued by a landlord in the 33rd Judicial District Court of Harris County, Texas for a Houston Bombshells which was under renovation in 2015. The plaintiff alleges RCI Hospitality Holdings, Inc.'s subsidiary, BMB Dining Services (Willowbrook), Inc., breached a lease agreement by constructing an outdoor patio, which allegedly interfered with the common areas of the shopping center, and by failing to provide Plaintiff with proposed plans before beginning construction. Plaintiff also asserts RCI Hospitality Holdings, Inc. is liable as guarantor of the lease. The lease was for a Bombshells restaurant to be opened in the Willowbrook Shopping Center in Houston, Texas. Both RCI Hospitality Holdings, Inc. and BMB Dining Services (Willowbrook), Inc. have denied liability and assert that Plaintiff has failed to mitigate its claimed damages. Further, BMB Dining Services (Willowbrook), Inc. asserts that Plaintiff affirmatively represented that the patio could be constructed under the lease and has filed counter claims and third-party claims against Plaintiff, Plaintiff's manager, and Plaintiff's broker asserting that they committed fraud and that the landlord breached the applicable agreements. It is unknown at this time whether the resolution of this uncertainty will have a material effect on the Company's financial condition.

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On June 23, 2014, Mark H. Dupray and Ashlee Dupray filed a lawsuit against Pedro Antonio Panameno and our subsidiary JAI Dining Services (Phoenix) Inc. (“JAI Phoenix”) in the Superior Court of Arizona for Maricopa County. The suit alleges that Mr. Panameno injured Mr. Dupray in a traffic accident after being served alcohol at an establishment operated by JAI Phoenix. The suit alleges JAI Phoenix is liable under theories of common law dram shop negligence and dram shop negligence per se. After a jury trial proceeded to a verdict in favor of the plaintiffs against both defendants, in April 2017 the Court entered a judgment under which JAI Phoenix’s share of compensatory damages is approximately \$1.4 million and its share of punitive damages is \$4 million. In May 2017, JAI Phoenix filed a motion for judgment as a matter of law or, in the alternative, motion for new trial. The Court denied this motion in August 2017. In September 2017, JAI Phoenix filed a notice of appeal. A hearing date for the appeal has not yet been scheduled. JAI Phoenix believes the Court’s assessments of liability and damages are unsupportable by the facts of the case and the law, and JAI Phoenix will continue to vigorously defend itself. RCI Hospitality Holdings, Inc. is not a party to the lawsuit. The Company estimates a possible loss in the range of \$0 to \$5.0 million in this matter.

Settlements of lawsuits for the quarters ended December 31, 2017 and 2016 total \$27,000 and \$73,000, respectively. As of December 31, 2017 and September 30, 2017, the Company has accrued \$37,000 and \$295,000 in accrued liabilities, respectively, related to settlement of lawsuits.

9. Segment Information

The Company owns and operates adult nightclubs and Bombshells Restaurants and Bars. The Company has identified such reportable segments based on management responsibility and the nature of the Company’s products, services and costs. There are no major distinctions in geographical areas served as all operations are in the United States. The Company measures segment profit (loss) as income (loss) from operations. Segment assets are those assets controlled by each reportable segment. The other category below includes our media divisions and rental income that are not significant to the consolidated financial statements.

Below is the financial information related to the Company’s segments (in thousands):

| | For the Three Months Ended December 31, | |
|--------------------------------------|--|------------------|
| | 2017 | 2016 |
| Revenues | | |
| Nightclubs | \$ 35,218 | \$ 29,282 |
| Bombshells | 5,828 | 4,295 |
| Other | 166 | 162 |
| | <u>\$ 41,212</u> | <u>\$ 33,739</u> |
| Income (loss) from operations | | |
| Nightclubs | \$ 13,371 | \$ 9,216 |
| Bombshells | 891 | 638 |
| Other | (137) | (341) |
| General corporate | (4,985) | (3,180) |
| | <u>\$ 9,140</u> | <u>\$ 6,333</u> |
| Depreciation and amortization | | |
| Nightclubs | \$ 1,335 | \$ 1,242 |
| Bombshells | 336 | 218 |
| Other | 2 | 5 |
| General corporate | 236 | 153 |
| | <u>\$ 1,909</u> | <u>\$ 1,618</u> |
| Capital expenditures | | |
| Nightclubs | \$ 450 | \$ 795 |
| Bombshells | 2,228 | 1,104 |
| Other | - | 1 |
| General corporate | 91 | 1,108 |
| | <u>\$ 2,769</u> | <u>\$ 3,008</u> |

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| | <u>December 31, 2017</u> | <u>September 30, 2017</u> |
|-------------------|--------------------------|---------------------------|
| Total assets | | |
| Nightclubs | \$ 248,187 | \$ 254,432 |
| Bombshells | 28,206 | 18,870 |
| Other | 969 | 780 |
| General corporate | 29,217 | 25,802 |
| | <u>\$ 306,579</u> | <u>\$ 299,884</u> |

General corporate expenses include corporate salaries, health insurance and social security taxes for officers, legal, accounting and information technology employees, corporate taxes and insurance, legal and accounting fees, depreciation and other corporate costs such as automobile and travel costs. Management considers these to be non-allocable costs for segment purposes.

10. Noncontrolling Interests

Noncontrolling interests represent the portion of equity in a consolidated entity held by owners other than the consolidating parent. Noncontrolling interests are reported in the consolidated balance sheets within equity, separately from stockholders' equity. Revenue, expenses and net income attributable to both the Company and the noncontrolling interests are reported in the consolidated statements of income.

Our consolidated financial statements include noncontrolling interests related principally to the Company's ownership of 51% of an entity which owns the real estate for the Company's nightclub in Philadelphia.

11. Related Party Transactions

Presently, our Chairman and President, Eric Langan, personally guarantees all of the commercial bank indebtedness of the Company. Mr. Langan receives no compensation or other direct financial benefit for any of the guarantees.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with our consolidated financial statements and related notes thereto included in this quarterly report, and the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended September 30, 2017.

Overview

RCI Hospitality Holdings, Inc. (“RCIHH”) is a holding company engaged in a number of activities in the hospitality and related businesses. All services and management operations are conducted by subsidiaries of RCIHH, including RCI Management Services, Inc.

Through our subsidiaries, as of December 31, 2017, we operated a total of 45 establishments that offer live adult entertainment, and/or restaurant and bar operations. We also operated a leading business communications company serving the multi-billion-dollar adult nightclub industry. We have two principal reportable segments: Nightclubs and Bombshells. We combine other operating segments into “Other.” In the context of club and restaurant/sports bar operations, the terms the “Company,” “we,” “our,” “us” and similar terms used in this report refer to subsidiaries of RCIHH. RCIHH was incorporated in the State of Texas in 1994. Our corporate offices are located in Houston, Texas.

Critical Accounting Policies and Estimates

The preparation of the unaudited consolidated financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On a regular basis, we evaluate these estimates, including investment impairment. These estimates are based on management’s historical industry experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

For a description of the accounting policies that, in management’s opinion, involve the most significant application of judgment or involve complex estimation and which could, if different judgment or estimates were made, materially affect our reported financial position, results of operations, or cash flows, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates” in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017 filed with the SEC on February 14, 2018.

During the three months ended December 31, 2017, there were no significant changes in our accounting policies and estimates.

Results of Operations

The following table summarizes our results of operations for the three months ended December 31, 2017 and 2016 (dollars in thousands):

| | For the Three Months Ended | | | | Change | |
|--|----------------------------|---------------|-------------------|---------------|------------------|---------|
| | December 31, 2017 | | December 31, 2016 | | Amount | % |
| | Amount | % of Revenues | Amount | % of Revenues | | |
| Revenues | | | | | | |
| Sales of alcoholic beverages | \$ 17,805 | 43.2% | \$ 14,375 | 42.6% | \$ 3,430 | 23.9% |
| Sales of food and merchandise | 5,307 | 12.9% | 4,207 | 12.5% | 1,100 | 26.1% |
| Service revenues | 15,889 | 38.6% | 13,475 | 39.9% | 2,414 | 17.9% |
| Other | 2,211 | 5.4% | 1,682 | 5.0% | 529 | 31.5% |
| Total revenues | <u>41,212</u> | 100.0% | <u>33,739</u> | 100.0% | <u>7,473</u> | 22.1% |
| Operating expenses | | | | | | |
| Cost of goods sold | | | | | | |
| Alcoholic beverages sold | 3,755 | 21.1% | 3,168 | 22.0% | 587 | 18.5% |
| Food and merchandise sold | 2,094 | 39.5% | 1,653 | 39.3% | 441 | 26.7% |
| Service and other | 36 | 0.2% | 60 | 0.4% | (24) | -40.0% |
| Cost of goods sold (exclusive of items shown separately below) | 5,885 | 14.3% | 4,881 | 14.5% | 1,004 | 20.6% |
| Salaries and wages | 11,377 | 27.6% | 9,652 | 28.6% | 1,725 | 17.9% |
| Selling, general and administrative | 12,812 | 31.1% | 11,193 | 33.2% | 1,619 | 14.5% |
| Depreciation and amortization | 1,909 | 4.6% | 1,618 | 4.8% | 291 | 18.0% |
| Other charges, net | 89 | 0.2% | 62 | 0.2% | 27 | 43.5% |
| Total operating expenses | <u>32,072</u> | 77.8% | <u>27,406</u> | 81.2% | <u>4,666</u> | 17.0% |
| Income from operations | 9,140 | 22.2% | 6,333 | 18.8% | 2,807 | 44.3% |
| Other income (expenses) | | | | | | |
| Interest expense | (3,079) | -7.5% | (2,015) | -6.0% | (1,064) | 52.8% |
| Interest income | 67 | 0.2% | 37 | 0.1% | 30 | 81.1% |
| Income before income taxes | 6,128 | 14.9% | 4,355 | 12.9% | 1,773 | 40.7% |
| Income tax expense (benefit) | (8,227) | -20.0% | 1,450 | 4.3% | (9,677) | -667.4% |
| Net income | <u>\$ 14,355</u> | 34.8% | <u>\$ 2,905</u> | 8.6% | <u>\$ 11,450</u> | 394.1% |

* Percentages may not foot due to rounding. Percentage of revenue for individual cost of goods sold items pertains to their respective revenue line.

Revenues

Consolidated revenues increased by \$7.5 million, or 22.1%, due primarily to a 16% increase from new units, 6.9% increase in same-store sales (contributing a 6.7% increase in total revenues), and a 0.7% decrease from closed units. Nightclub and Bombshells same-store sales increased by 7.1% and 5.6%, respectively, due to strong lineup of sporting events pulling in increased customer count, and a continued recovery in consumer spending.

Segment contribution to total revenues was as follows (in thousands):

| | For the Three Months Ended December 31, | |
|------------|--|------------------|
| | 2017 | 2016 |
| Nightclubs | \$ 35,218 | \$ 29,282 |
| Bombshells | 5,828 | 4,295 |
| Other | 166 | 162 |
| | <u>\$ 41,212</u> | <u>\$ 33,739</u> |

Operating Expenses

Total operating expenses, as a percent of revenues, decreased to 77.8% from 81.2% from year-ago although dollar value increased by \$4.7 million, or 17.0%, which was predominantly caused by the 22.1% increase in total revenues. Contributors to the changes in operating expenses are explained below.

Cost of goods sold increased by \$1.0 million, or 20.6%, primarily due to increase in sales. As a percent of total revenues, cost of goods sold slightly decreased to 14.3% from 14.5% mainly due to the increase in revenue mix of higher margin service revenue from units in the same-store sales base, partially offset by slightly lower margin new restaurant food sales.

Salaries and wages increased by \$1.7 million, or 17.9% mainly due to a shift to additional corporate headcount and labor from newly acquired and opened units. As a percent of total revenues, salaries and wages decreased to 27.6% from 28.6% primarily due to leverage from higher sales.

Selling, general and administrative expenses increased by \$1.6 million, or 14.5%, primarily due to increases in charge card fees, advertising and marketing, audit fee, insurance, rent, supplies, and repairs and maintenance. This is partially offset by decreases in legal costs and taxes and permits. Charge card fees and supplies are directly related to the increase in sales. Rent increased due to the opening of a new Bombshells. As a percent of total revenues, selling, general and administrative expenses decreased to 31.1% from 33.2% mainly due sales leverage partially offset by a higher mix of credit card usage.

Depreciation and amortization increased by \$291,000, or 18.0% due to higher unit count and the addition of our corporate office during the middle of the first quarter of 2017.

Income from Operations

For the three months ended December 31, 2017 and 2016, our operating margin was 22.2% and 18.8%, respectively. The main drivers for the increase in operating margin is the favorable leverage caused by fixed expenses on increasing sales and the contribution of newly acquired and opened units, aside from the details previously discussed above.

Segment contribution to income from operations is presented in the table below (in thousands):

| | For the Three Months Ended December 31, | |
|-------------------|--|-----------------|
| | 2017 | 2016 |
| Nightclubs | \$ 13,371 | \$ 9,508 |
| Bombshells | 891 | 638 |
| Other | (137) | (341) |
| General corporate | (4,985) | (3,180) |
| | <u>\$ 9,140</u> | <u>\$ 6,333</u> |

Operating margin for the Nightclubs segment was 38.0% and 31.5% for the three months ended December 31, 2017 and 2016, respectively, while operating margin for Bombshells was 15.3% and 14.9%, respectively. The increase in Nightclubs operating margin was mainly due to the favorable leverage caused by fixed expenses on increasing sales and the contribution of newly acquired and opened units. The increase in Bombshells operating margin was primarily due to positive same-stores sales, partially offset by the underperformance of our Austin, Texas location.

Non-Operating Items

Interest expense increased to \$3.1 million from \$2.0 million due to the writeoff of debt issuance costs and prepayment penalties related to our debt refinancing (see Note 4 to our condensed consolidated financial statements) amounting to \$827,000 and higher average debt balance quarter over quarter.

Our total occupancy, defined as the sum of rent expense and interest expense, exclusive of refinancing-related costs above, was 7.7% and 8.0% of revenue during the quarter ended December 31, 2017 and 2016, respectively.

Income Taxes

Income taxes were a benefit of \$8.1 million for the first quarter of 2018 compared to an expense of \$1.5 million for the same quarter of 2017. The effective income tax rate for the first quarter of 2018 was a benefit of 134.3% compared with an expense of 33.3% for the comparable period of 2017. Our effective tax rate is affected by state taxes, permanent differences, and tax credits, including the FICA tip credit, for both years while the first quarter of 2018 was significantly impacted by a \$9.7 million reduction of our deferred tax liability caused by newly enacted tax laws.

On December 22, 2017, the Tax Cuts and Jobs Act was enacted into law, which provides for significant changes to the U.S. Internal Revenue Code of 1986, as amended, such as a reduction in the statutory federal corporate tax rate from 35% to 21% effective from January 1, 2018 forward and changes or limitations to certain tax deductions. The Company has a fiscal year end of September 30, so the change to the statutory corporate tax rate results in a blended federal statutory tax rate of 24.5% for its fiscal year 2018. The financial statements for the first fiscal quarter 2018 were also impacted by a one-time revaluation of the Company's deferred tax assets and liabilities and this was recognized as a discrete income tax benefit in the period. The Company estimates that its annual effective tax rate for fiscal 2018 (blended rate year) will be approximately 26.5%. The effective tax rate for the current quarter was lower than the new 2018 statutory rate due to discrete tax benefits of \$9.7 million recognized related to the revaluation of deferred tax assets and liabilities expected to be utilized in 2018.

Non-GAAP Financial Measures

In addition to our financial information presented in accordance with GAAP, management uses certain non-GAAP financial measures, within the meaning of the SEC Regulation G, to clarify and enhance understanding of past performance and prospects for the future. Generally, a non-GAAP financial measure is a numerical measure of a company's operating performance, financial position or cash flows that excludes or includes amounts that are included in or excluded from the most directly comparable measure calculated and presented in accordance with GAAP. We monitor non-GAAP financial measures because it describes the operating performance of the Company and helps management and investors gauge our ability to generate cash flow, excluding items that management believes are not representative of the ongoing business operations of the Company, but are included in the most directly comparable measures calculated and presented in accordance with GAAP. Relative to each of the non-GAAP financial measures, we further set forth our rationale as follows:

Non-GAAP Operating Income and Non-GAAP Operating Margin. We exclude from non-GAAP operating income and non-GAAP operating margin amortization of intangibles, gains or losses on sale of assets, gain on insurance, and settlement of lawsuits. We believe that excluding these items assists investors in evaluating period-over-period changes in our operating income and operating margin without the impact of items that are not a result of our day-to-day business and operations.

Non-GAAP Net Income and Non-GAAP Net Income per Diluted Share. We exclude from non-GAAP net income and non-GAAP net income per diluted share amortization of intangibles, costs and charges related to debt refinancing, income tax expense (benefit), gains or losses on sale of assets, gain on insurance, and settlement of lawsuits, and include the non-GAAP provision for current and deferred income taxes, calculated at 26.5% and 33% effective tax rate of the pre-tax non-GAAP income before taxes for the quarter ended December 31, 2017 and 2016, respectively, because we believe that excluding and including such items help management and investors better understand our operating activities.

Adjusted EBITDA. We exclude from adjusted EBITDA depreciation expense, amortization of intangibles, income tax expense (benefit), net interest expense, gains or losses on sale of assets, gain on insurance, and settlement of lawsuits because we believe that adjusting for such items helps management and investors better understand operating activities. Adjusted EBITDA provides a core operational performance measurement that compares results without the need to adjust for federal, state and local taxes which have considerable variation between domestic jurisdictions. The results are, therefore, without consideration of financing alternatives of capital employed. We use adjusted EBITDA as one guideline to assess our unleveraged performance return on our investments. Adjusted EBITDA is also the target benchmark for our acquisitions of nightclubs.

We also use certain non-GAAP cash flow measures such as free cash flow. See "Liquidity and Capital Resources" section for further discussion.

The following tables present our non-GAAP performance measures for the quarters ended December 31, 2017 and 2016 (in thousands, except per share amounts and percentages):

| | For the Three Months Ended December 31, | |
|---|--|-----------------|
| | 2017 | 2016 |
| Reconciliation of GAAP net income to Adjusted EBITDA | | |
| Net income attributable to RCIHH common shareholders | \$ 14,311 | \$ 2,898 |
| Income tax expense (benefit) | (8,227) | 1,450 |
| Interest expense, net | 3,012 | 1,978 |
| Settlement of lawsuits | 27 | 73 |
| Loss (gain) on sale of assets | 82 | (11) |
| Gain on insurance | (20) | - |
| Depreciation and amortization | 1,909 | 1,618 |
| Adjusted EBITDA | <u>\$ 11,094</u> | <u>\$ 8,006</u> |
| Reconciliation of GAAP net income to non-GAAP net income | | |
| Net income attributable to RCIHH common shareholders | \$ 14,311 | \$ 2,898 |
| Amortization of intangibles | 48 | 46 |
| Costs and charges related to debt refinancing | 827 | - |
| Settlement of lawsuits | 27 | 73 |
| Income tax expense (benefit) | (8,227) | 1,450 |
| Loss (gain) on sale of assets | 82 | (11) |
| Gain on insurance | (20) | - |
| Non-GAAP benefit (expense) for income taxes | | |
| Current | 45 | (1,455) |
| Deferred | (1,913) | (15) |
| Non-GAAP net income | <u>\$ 5,180</u> | <u>\$ 2,986</u> |
| Reconciliation of GAAP diluted net income per share to non-GAAP diluted net income per share | | |
| Fully diluted shares | 9,719 | 9,814 |
| GAAP diluted net income per share | \$ 1.47 | \$ 0.30 |
| Amortization of intangibles | 0.00 | 0.00 |
| Costs and charges related to debt refinancing | 0.09 | - |
| Settlement of lawsuits | 0.00 | 0.01 |
| Income tax expense (benefit) | (0.85) | 0.15 |
| Loss (gain) on sale of assets | 0.01 | (0.00) |
| Gain on insurance | (0.00) | - |
| Non-GAAP benefit (expense) for income taxes | | |
| Current | 0.00 | (0.15) |
| Deferred | (0.19) | (0.00) |
| Non-GAAP diluted net income per share | <u>\$ 0.53</u> | <u>\$ 0.31</u> |
| Reconciliation of GAAP operating income to non-GAAP operating income | | |
| Income from operations | \$ 9,140 | \$ 6,333 |
| Amortization of intangibles | 48 | 46 |
| Settlement of lawsuits | 27 | 73 |
| Loss (gain) on sale of assets | 82 | (11) |
| Gain on insurance | (20) | - |
| Non-GAAP operating income | <u>\$ 9,277</u> | <u>\$ 6,441</u> |
| Reconciliation of GAAP operating margin to non-GAAP operating margin | | |
| GAAP operating margin | 22.2% | 18.8% |
| Amortization of intangibles | 0.1% | 0.1% |
| Settlement of lawsuits | 0.0% | 0.2% |
| Loss (gain) on sale of assets | 0.2% | -0.0% |
| Gain on insurance | -0.0% | - |
| Non-GAAP operating margin | <u>22.5%</u> | <u>19.1%</u> |

* Per share amounts and percentages may not foot due to rounding.

The adjustments to reconcile net income attributable to RCIHH common shareholders to non-GAAP net income exclude the impact of adjustments related to noncontrolling interests, which is immaterial. In the calculation of non-GAAP diluted net income per share, we take into consideration the adjustment to net income from the assumed conversion of debentures (see Note 6 to the condensed consolidated financial statements).

Liquidity and Capital Resources

At December 31, 2017, our cash and cash equivalents were \$12.0 million compared to \$9.9 million at September 30, 2017. Because of the large volume of cash we handle, we have very stringent cash controls. As of December 31, 2017, we had negative working capital of \$6.2 million compared to negative working capital of \$10.6 million as of September 30, 2017, both figures excluding assets held for sale of \$5.6 million as of December 31, 2017 and \$5.8 million as of September 30, 2017. We believe our ability to generate cash from operating activities is one of our fundamental financial strengths. Our net cash provided by operating activities increased to \$8.1 million during the quarter ended December 31, 2017 from \$5.5 million during the quarter ended December 31, 2016. The near-term outlook for our business remains strong, and we expect to generate substantial cash flows from operations for the entire fiscal 2018. As a result of our expected cash flows from operations, we have significant flexibility to meet our financial commitments.

We have not recently raised capital through the issuance of equity securities. Instead, we use debt financing to lower our overall cost of capital and increase our return on stockholders' equity. We have a history of borrowing funds in private transactions and from sellers in acquisition transactions, and recently have secured a significant refinancing of several of our notes payable. We continue to have the ability to borrow funds at reasonable interest rates in that manner. We also have historically utilized these cash flows to invest in property and equipment, adult nightclubs and restaurants/sports bars.

The following table presents a summary of our cash flows from operating, investing, and financing activities (in thousands):

| | For the Three Months Ended December 31, | |
|---|--|---------------|
| | 2017 | 2016 |
| Operating activities | \$ 8,145 | \$ 5,521 |
| Investing activities | (2,089) | (2,988) |
| Financing activities | (4,024) | (1,796) |
| Net increase in cash and cash equivalents | <u>\$ 2,032</u> | <u>\$ 737</u> |

Cash Flows from Operating Activities

Following are our summarized cash flows from operating activities (in thousands):

| | For the Three Months Ended December 31, | |
|--|--|-----------------|
| | 2017 | 2016 |
| Net income | \$ 14,355 | \$ 2,905 |
| Depreciation and amortization | 1,909 | 1,618 |
| Deferred tax benefit | (9,697) | - |
| Debt prepayment penalty | 543 | - |
| Net change in operating assets and liabilities | 516 | 873 |
| Other | 519 | 125 |
| Net cash provided by operating activities | <u>\$ 8,145</u> | <u>\$ 5,521</u> |

Net cash provided by operating activities increased from year-to-year due primarily to the increase in income from operations and lower income taxes paid, partially offset by higher interest expense paid, which included debt prepayment penalty, and an unfavorable net change in operating assets and liabilities.

Cash Flows from Investing Activities

Following are our cash flows from investing activities (in thousands):

| | For the Three Months Ended December 31, | |
|---------------------------------------|--|-------------------|
| | 2017 | 2016 |
| Additions to property and equipment | \$ (2,769) | \$ (3,008) |
| Proceeds from sale of assets | 632 | - |
| Proceeds from insurance | 20 | - |
| Proceeds from notes receivable | 28 | 20 |
| Net cash used in investing activities | <u>\$ (2,089)</u> | <u>\$ (2,988)</u> |

Following is a breakdown of our additions to property and equipment for the quarters ended December 31, 2017 and 2016 (in thousands):

| | For the Three Months Ended December 31, | |
|-------------------------------------|--|-----------------|
| | 2017 | 2016 |
| New facilities capital expenditures | \$ 2,161 | \$ 2,614 |
| Maintenance capital expenditures | 608 | 394 |
| Total capital expenditures | \$ 2,769 | \$ 3,008 |

The capital expenditures during the quarter ended December 31, 2017 is composed primarily of construction and development costs for one new location, while the capital expenditures during the quarter ended December 31, 2016 is composed primarily of construction and development costs for three new locations and our new corporate office. Variances in capital expenditures are primarily due to the number and timing of new, remodeled, or reconcepted locations under construction.

Cash Flows from Financing Activities

Following are our cash flows from financing activities (in thousands):

| | For the Three Months Ended December 31, | |
|--|--|-------------------|
| | 2017 | 2016 |
| Proceeds from long-term debt | \$ 58,920 | \$ 1,900 |
| Payments on long-term debt | (61,256) | (2,152) |
| Debt prepayment penalty | (543) | - |
| Purchase of treasury stock | - | (1,101) |
| Payment of loan origination costs | (799) | (99) |
| Payment of dividends | (292) | (290) |
| Distribution to noncontrolling interests | (54) | (54) |
| Net cash used in financing activities | \$ (4,024) | \$ (1,796) |

We did not purchase shares of our Company's common stock during the quarter ended December 31, 2017, while, we purchased 89,685 treasury shares at an average price of \$12.25 per share during the quarter ended December 31, 2016. We paid quarterly dividends of \$0.03 per share during both current and prior year quarters.

On December 14, 2017, we refinanced several of our notes payable with a local bank. Refer to Note 4 to our condensed consolidated financial statements for details of the refinancing.

Subsequent to quarter-end, we borrowed \$3.0 million from a bank for the purchase of land worth \$4.0 million, and refinanced one of our bank notes with a construction loan amounting to \$4.7 million. See Note 4 to our condensed consolidated financial statements for details of these transactions.

Management also uses certain non-GAAP cash flow measures such as free cash flow. Free cash flow is derived from net cash provided by operating activities less maintenance capital expenditures. We use free cash flow as the baseline for the implementation of our capital allocation strategy.

| | For the Three Months Ended December 31, | |
|---|--|-----------------|
| | 2017 | 2016 |
| Net cash provided by operating activities | \$ 8,145 | \$ 5,521 |
| Less: Maintenance capital expenditures | 608 | 394 |
| Free cash flow | \$ 7,537 | \$ 5,127 |

Other than the debt refinancing described above, we are not aware of any event or trend that would potentially significantly affect liquidity. In the event such a trend develops, we believe our working capital and capital expenditure requirements will be adequately met by cash flows from operations. In our opinion, working capital is not a true indicator of our financial status. Typically, businesses in our industry carry current liabilities in excess of current assets because businesses in our industry receive substantially immediate payment for sales, with nominal receivables, while inventories and other current liabilities normally carry longer payment terms. Vendors and purveyors often remain flexible with payment terms, providing businesses in our industry with opportunities to adjust to short-term business down turns. We consider the primary indicators of financial status to be the long-term trend of revenue growth, the mix of sales revenues, overall cash flow, profitability from operations and the level of long-term debt.

The following table presents a summary of such indicators for the quarters ended December 31:

| | 2017 | Increase (Decrease) | 2016 | Increase (Decrease) | 2015 |
|---|---------------|------------------------|---------------|------------------------|---------------|
| Sales of alcoholic beverages | \$ 17,805 | 23.9% | \$ 14,375 | -1.5% | \$ 14,597 |
| Sales of food and merchandise | 5,307 | 26.1% | 4,207 | -2.9% | 4,334 |
| Service revenues | 15,889 | 17.9% | 13,475 | 6.6% | 12,641 |
| Other | 2,211 | 31.5% | 1,682 | -11.6% | 1,903 |
| Total revenues | 41,212 | 22.1% | 33,739 | 0.8% | 33,475 |
| Net cash provided by operating activities | \$ 8,145 | 47.5% | \$ 5,521 | 31.4% | \$ 4,202 |
| Adjusted EBITDA | \$ 11,094 | 38.6% | \$ 8,006 | -2.2% | \$ 8,187 |
| Long-term debt | \$ 125,992 | 19.3% | \$ 105,620 | 11.9% | \$ 94,356 |

* See definition of Adjusted EBITDA above under the Non-GAAP Financial Measures subsection of Results of Operations.

Share Repurchase

We did not purchase shares of our common stock during the quarter ended December 31, 2017, while we purchased 89,685 shares of our stock at an average price of \$12.25 per share during the quarter ended December 31, 2016. As of December 31, 2017, we have \$3.1 million remaining to purchase additional shares under our share repurchase program.

Other Liquidity and Capital Resources

We have not established financing other than the notes payable, including the New Loan discussed in Note 4 to the consolidated financial statements and our existing \$1.0 million line of credit facility. There can be no assurance that we will be able to obtain additional financing on reasonable terms in the future, if at all, should the need arise.

We believe that the adult entertainment industry standard of treating entertainers as independent contractors provides us with safe harbor protection to preclude payroll tax assessment for prior years. We have prepared plans that we believe will protect our profitability in the event that the sexually oriented business industry is required in all states to convert dancers who are now independent contractors into employees.

The sexually-oriented business industry is highly competitive with respect to price, service and location, as well as the professionalism of the entertainment. Although management believes that we are well-positioned to compete successfully in the future, there can be no assurance that we will be able to maintain our high level of name recognition and prestige within the marketplace.

Impact of Inflation

We have not experienced a material overall impact from inflation in our operations during the past several years. To the extent permitted by competition, we have managed to recover increased costs through price increases and may continue to do so. However, there can be no assurance that we will be able to do so in the future.

Seasonality

Our nightclub operations are affected by seasonal factors. Historically, we have experienced reduced revenues from April through September (our fiscal third and fourth quarters) with the strongest operating results occurring during October through March (our fiscal first and second quarters).

Growth Strategy

We believe that our nightclub operations can continue to grow organically and through careful entry into markets and demographic segments with high growth potential. Our growth strategy involves the following: (i) to acquire existing units in locations that are consistent with our growth and income targets and which appear receptive to the upscale club formula we have developed; (ii) to open new units after market analysis; (iii) to franchise our Bombshells brand; (iv) to form joint ventures or partnerships to reduce start-up and operating costs, with us contributing equity in the form of our brand name and management expertise; (v) to develop new club concepts that are consistent with our management and marketing skills; (vi) to develop and open our restaurant concepts as our capital and manpower allow; and (vii) to control the real estate in connection with club operations, although some units may be in leased premises.

We believe that Bombshells can grow organically and through careful entry into markets and demographic segments with high growth potential. All five of the currently existing Bombshells are located in Texas. Our growth strategy is to diversify our operations with these units which do not require SOB licenses, which are sometimes difficult to obtain. While we are searching for adult nightclubs to acquire, we are able to also search for restaurant/sports bar locations that are consistent with our income targets.

We plan to open two Bombshells in fiscal 2018.

We continue to evaluate opportunities to acquire new nightclubs and anticipate acquiring new locations that fit our business model as we have done in the past. The acquisition of additional clubs may require us to take on additional debt or issue our common stock, or both. There can be no assurance that we will be able to obtain additional financing on reasonable terms in the future, if at all, should the need arise. An inability to obtain such additional financing could have an adverse effect on our growth strategy.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As of December 31, 2017, there were no material changes to the information provided in Item 7A of the Company's Annual Report on Form 10-K for fiscal year ended September 30, 2017.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures, defined in Rule 13a-15(e) under the Exchange Act, that are designed to ensure that the information required to be filed or submitted with the SEC under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management of the company with the participation of its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required.

In connection with the preparation of this Quarterly Report on Form 10-Q for the quarter ended December 31, 2017, an evaluation was performed under the supervision and with the participation of management, including the chief executive officer and chief financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on their evaluation, they have concluded that our disclosure controls and procedures were not effective as of December 31, 2017. This determination is based on the material weaknesses management previously identified in our internal control over financial reporting, as described below. We are in the process of remediating the material weaknesses, as described below, which should remedy our disclosure controls and procedures, but we will continue to monitor this issue.

Material Weaknesses in Internal Control Over Financial Reporting

In our Annual Report for the year ended September 30, 2017, filed with the SEC on February 14, 2018, management concluded that our internal control over financial reporting was not effective as of September 30, 2017. In management's evaluation, the following deficiencies were identified as material weaknesses:

- Control Environment
 - Lack of effective control environment, which was primarily attributable to not having a sufficient complement of accounting and financial reporting personnel with an appropriate level of knowledge to address our financial reporting requirements which contributed to the following material weaknesses:
- Control Activities
 - Lack of sufficient complement to design and maintain effective controls over complex accounting and management estimates related to assets held for sale, business combinations, cost method investments, income taxes, and the impairment analyses for indefinite lived intangible assets, goodwill, and property and equipment;
 - Lack of effective controls to support accurate accounting, reporting, and disclosures within our Form 10-K; and
 - Lack of effective controls to prevent unauthorized access to certain systems, programs and data, and provide for periodic review and monitoring of access including review of security logs and analysis of segregation of duties conflicts.

Remediation Efforts to Address Material Weaknesses

As disclosed in our most recent Annual Report on Form 10-K, we have, and continue to, identify and implement actions to improve our internal control over financial reporting and disclosure controls and procedures including actions to enhance our resources and training with respect to financial reporting and disclosure responsibilities, and increase utilization of accounting system functionality, with continued oversight from the Audit Committee.

We have taken, and continue to take, the actions described below to remediate the identified material weaknesses. As we continue to evaluate and work to improve our internal controls over financial reporting, our senior management may determine to take additional measures to address control deficiencies or determine to modify the remediation efforts described in this section. While the Audit Committee and senior management are closely monitoring the implementation, until the remediation efforts discussed in this section, including any additional remediation efforts that our senior management identifies as necessary, are completed, tested and determined effective, the material weaknesses described above will continue to exist.

Control Environment

Our Board of Directors has directed senior management to ensure that a proper, consistent tone is communicated throughout the organization, which emphasizes the expectation that previously existing deficiencies will be rectified through implementation of processes and controls to ensure strict compliance with US GAAP and regulatory requirements. We also have taken steps to effect a proper tone through our policies and personnel.

Control Activities

Strengthening internal controls over complex accounting and management estimates – Subsequent to September 30, 2017, we have committed to resolve the controls over complex accounting and estimates and prevent instances of incorrect accounting and improper valuation decisions, by hiring valuation experts to assist us with our goodwill, indefinite-lived intangible assets, and property and equipment impairment analyses whenever necessary and with the analysis and accounting for business combinations, income taxes, and other complex accounting matters.

Strengthening internal controls over financial reporting and disclosures - We believe the new Enterprise Resource Planning (“ERP”) system described below will assist us in strengthening the controls over financial reporting, and we are committed to also add an overlay of review of our financial statements during our financial reporting process. We have also upgraded our accounting staff with certain newly hired accountants.

We have also committed to hiring an outsourced internal audit group to assist with the controls over these processes and other internal control functions.

With the oversight of our Board of Directors and Audit Committee, the Company has also begun taking steps and plans to take additional measures to remediate the underlying causes of the material weaknesses.

Strengthening the information technology application and related segregation of duties issues – We were previously aware of the limitations of our accounting software and had been in the planning/implementation process of replacing the software for many months prior to September 30, 2017. In October 2017, we completed the conversion to a new ERP system which, along with changes to our manual internal controls, we believe will resolve the issues detailed above relating to the information systems and segregation of duties. The new ERP system has features that prevent unauthorized access to certain programs and data, and provides for periodic review and monitoring of access including review of security logs and analysis of segregation of duties conflicts. These features include proper segregation of duties within our journal entry process. We have also hired a Director of ERP & Business Intelligence.

Changes in Internal Control Over Financial Reporting

Other than as described above, no changes in the Company’s internal control over financial reporting that occurred during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

See the “Legal Matters” section within Note 8 of the condensed consolidated financial statements within this Quarterly Report on Form 10-Q, which information is incorporated herein by reference.

Item 1A. Risk Factors.

There were no material changes to the risk factors disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2017. The risks described in the Annual Report on Form 10-K are not the only risks the Company faces. Additional risks and uncertainties not currently known to the Company, or that the Company deems to be immaterial, also may have a material adverse impact on the Company’s business, financial condition or results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

In September 2008, our Board of Directors authorized us to repurchase up to \$5.0 million worth of our common stock in the open market or in privately negotiated transactions. As of April 2013, we completed the repurchase of all \$5.0 million in stock authorized under this plan. In April 2013, our Board of Directors authorized us to repurchase up to an additional \$3.0 million worth of our common stock, and in May 2014, our Board of Directors increased the repurchase authorization by another \$7.0 million. In May 2016, the Board of Directors increased the repurchase authorization by an additional \$5.0 million. During the quarter ended December 31, 2017, we did not repurchase shares of the Company’s common stock. As of December 31, 2017, we have \$3.1 million remaining to purchase additional shares.

Item 6. Exhibits.

| Exhibit No. | Description |
|--------------------|---|
| 3.1 | Articles of Incorporation dated December 9, 1994. (Incorporated by reference from Form SB-2 filed with the SEC on January 11, 1995.) * |
| 3.2 | Certificate of Amendment to Articles of Incorporation dated September 9, 2008. (Incorporated by reference from Definitive Schedule 14A filed with the SEC on July 21, 2008.) * |
| 3.3 | Certificate of Amendment to Articles of Incorporation dated August 6, 2014. (Incorporated by reference from Definitive Schedule 14A filed with the SEC on June 24, 2014.) * |
| 3.4 | Amended and Restated Bylaws. (Incorporated by reference from Form 8-K filed with the SEC on March 16, 2016.) * |
| 4.1 | Consolidated, Amended and Restated Promissory Note for \$62,539,366.08 with Centennial Bank (Incorporated by reference from Form 8-K filed with the SEC on December 19, 2017) * |
| 4.2 | Amended and Restated Promissory Note for \$10,558,311.35 with Centennial Bank (Incorporated by reference from Form 8-K filed with the SEC on December 19, 2017) * |
| 4.3 | Amended and Restated Promissory Note for \$8,147,572.57 with Centennial Bank (Incorporated by reference from Form 8-K filed with the SEC on December 19, 2017) * |
| 10.1 | Employment Agreement with Eric S. Langan. (Incorporated by reference from Form 8-K filed with the SEC on July 27, 2015.) * |
| 10.2 | Employment Agreement with Travis Reese. (Incorporated by reference from Form 8-K filed with the SEC on September 19, 2014.) * |
| 10.3 | Employment Agreement with Phillip K. Marshall. (Incorporated by reference from Form 8-K filed with the SEC on August 5, 2016.) * |
| 10.4 | Loan Agreement between RCI Holdings, Inc. and Centennial Bank (Incorporated by reference from Form 8-K filed with the SEC on December 19, 2017) * |
| 10.5 | Absolute Unconditional and Continuing Guaranty of RCI Hospitality Holdings, Inc. to Centennial Bank (Incorporated by reference from Form 8-K filed with the SEC on December 19, 2017) * |
| 10.6 | Absolute Unconditional and Continuing Guaranty of Eric S. Langan to Centennial Bank (Incorporated by reference from Form 8-K filed with the SEC on December 19, 2017) * |
| 31.1 | Certification of Chief Executive Officer of RCI Hospitality Holdings, Inc. required by Rule 13a-14(1) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer of RCI Hospitality Holdings, Inc. required by Rule 13a-14(1) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer of RCI Hospitality Holdings, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and Section 1350 of 18 U.S.C. 63. |
| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema Document. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document. |

* Incorporated by reference from our previous filings with the SEC.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

RCI HOSPITALITY HOLDINGS, INC.

Date: March 7, 2018

By: /s/ Eric S. Langan

Eric S. Langan
Chief Executive Officer and President

Date: March 7, 2018

By: /s/ Phillip K. Marshall

Phillip K. Marshall
Chief Financial Officer and Principal Accounting Officer

**CERTIFICATION PURSUANT TO SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Eric S. Langan, Chief Executive Officer and President of RCI Hospitality Holdings, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of RCI Hospitality Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this report;
4. The issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the issuer and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting; and
5. The issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the issuer's independent registered public accounting firm and the audit committee of the issuer's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the issuer's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal control over financial reporting.

Date: March 7, 2018

By: /s/ Eric S. Langan

Eric S. Langan
Chief Executive Officer and President

**CERTIFICATION PURSUANT TO SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Phillip K. Marshall, Chief Financial Officer of RCI Hospitality Holdings, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of RCI Hospitality Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this report;
4. The issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the issuer and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting; and
5. The issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the issuer's independent registered public accounting firm and the audit committee of the issuer's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the issuer's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal control over financial reporting.

Date: March 7, 2018

By: /s/ Phillip K. Marshall

Phillip K. Marshall
Chief Financial Officer and Principal Accounting Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of RCI Hospitality Holdings, Inc. (the "Company") on Form 10-Q for the fiscal period ended December 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, the Chief Executive Officer and the Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that based on our knowledge, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company as of and for the periods covered in the Report.

/s/ Eric S. Langan

Eric S. Langan
Chief Executive Officer
March 7, 2018

/s/ Phillip K. Marshall

Phillip K. Marshall
Chief Financial Officer
March 7, 2018

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to RCI Hospitality Holdings, Inc. and will be retained by RCI Hospitality Holdings, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished to the Securities and Exchange Commission as an exhibit to the Form 10-Q and shall not be considered filed as part of the Form 10-Q.
