Transcript of
RCI Hospitality Holdings, Inc.
Presentation at H.C. Wainwright 26th Annual Global Investment Conference
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Participants

Eric Langan - President and CEO, RCI Hospitality Holdings, Inc.

Presentation

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Thank you. Here are our Forward Looking Statements. We urge you to read them. Our presentation also includes non-GAAP financial measures. We urge you to pay attention to that slide, too.

RCI Hospitality Holdings is the only publicly traded company that specializes in acquiring and managing adult nightclubs. We believe this is a compelling investment opportunity. Adult nightclubs are a classic, timeless and legal segment of the adult entertainment industry. Clubs produce generally consistent and predictable cash flows. There are high barriers to entry and limited competition. The market is fragmented and there are significant acquisition opportunities.

But before we go on, I want you to know times have changed. The popular impression is that adult nightclubs are small out of the way places that you'd never want to go to. The reality is that a growing number of clubs today are big, beautiful, professionally run establishments where men and women have lots of fun. This is a photo of our Tootsies Cabaret Miami. With 78,000 square feet, it is one of the largest nightclubs in the world.

We own 56 locations in 13 states. The five largest in terms of revenue are Texas, Florida, NY, Illinois and Colorado. We have more than 20 brands. Many of them are very well known. We offer a wide variety of formats that appeal to Gen Z, Millennials, Gen X and Baby Boomers; white and blue collar workers; and White, Black and Hispanic audiences. Few municipalities are issuing new adult club licenses, so in most cities we enjoy a moat around our business. We have excellent unit economics. More than 80% of sales come from high-margin liquor and service revenues. Inventory, mainly alcoholic beverages, turns very quickly, and locations require low capital expenditures. We also own most of the real estate that our clubs operate in.

In addition to Tootsies, some of our top brands include the high-end Rick's Cabaret, the Las Vegas-style nightclub Scarlett's, and the world-famous Baby Dolls in Texas. Just last month, Scarlett's Cabaret Miami was named the Overall Club of the Year at the annual industry convention.

[1] This is a clean verbatim transcription that has been edited to increase readability.

We also own a chain of 12 Bombshells. It's a big Texas-style, sports bar restaurant concept featuring pretty waitresses. We generated 100% return on capital since inception. Because it was so large and open during COVID, Bombshells overperformed during that time period. Since then, sales and margins have fallen. We are in the process of improving operations, finishing our new builds, and continuing to explore strategic options with the brand.

Having said all that, the real business of our company is generating free cash flow per share. To guide us in that we initiated our capital allocation strategy in 2015. It governs the use of free cash flow, creates financial discipline, and is focused on shareholder value. It was inspired by the book *The Outsiders* by William Thorndike. Under this strategy, we use cash for club acquisitions that can produce at least 25-33% cash on cash returns; share buybacks when our free cash flow yield on shares is 10% or more; debt repayment if the after-tax yield is 10% or greater; and to increase our dividend. Our target is to grow free cash flow per share at an average compound annual rate of 10-15%.

We have a strong track record of success. This slide shows our progress since fiscal 2015 when we initiated our capital allocation strategy through the most recent third quarter of fiscal 2024. Trailing 12-month total revenues have grown 120% to $298 million. The number of our locations has increased by 63% to 70 as of June 30, 2024. Trailing 12-month net cash flow provided by operating activities has grown by 219% to $52 million. During the same period, trailing 12-month free cash flow increased by 211% to $46 million, and share count has declined by 13% to less than nine million shares as of August 5th, 2024, the last reported date. Our stock price has risen 346% as of August 9th, 2024, the day after we reported third quarter 2024. This compares to 178% for the S&P 500.

All this provides us with a unique advantage. We're the exit strategy for the industry. We pay three to five times adjusted EBITDA for clubs and market price for the real estate. We like to buy good, solid cash flowing clubs, no fixer uppers. We are able to provide a sizable upfront cash down payment, and we have an unblemished record of paying off our seller financing. We have three major sources for cash: Our own free cash flow, periodic cash out bank refinancings of our real estate, and over the years, we have assembled a group of private investors willing to lend us cash at favorable terms. Key members of our club management company have been in place for a long time. Over the years, we have developed methods proven to increase acquired club EBITDA by about 10 to 20%. Our scale enables us to provide purchasing power, legal services, and security at levels most club owners can't afford.

Over the last few years, we have achieved some major accomplishments. We more than survived COVID. We then managed the post-COVID bounce. Then we made our two biggest acquisitions ever. We successfully integrated them and improved their results. Now that things have settled down and given the uncertain economic environment, we wanted to take a good hard look at what we should be doing to increase our free cash flow per share and return value to our investors. We are currently working on a five year strategic plan for implementation starting in fiscal 2025, which begins in October. Right now we see two main pillars to this plan.

The first is to continue our “Back to Basics” approach to business. We are going back to being a pure play on adult nightclubs. Looking at our list of new projects, we have opened, converted and/or enhanced seven locations during this fiscal year. We are working on opening, reopening and/or reformatting seven more as fast and efficiently as possible. We also want to make sure all locations are running as efficiently and profitably as possible. We are focused on growing same store sales and improving margins. If we have any underperforming locations, we are trying to rebrand or reformat them, and if that doesn't work, we will look at divesting them.

The second pillar is capital allocation. Assuming no growth, we should have approximately $200-$250 million of free cash flow over the next five years. After debt service, our priorities will be to target 50% of our free cash flow to be used in M&A, focusing on base hits and the occasional home run, but making sure we capture synergies at the acquired clubs; less than 10% to ensure a stable and modestly growing dividend; and any excess not used for M&A or dividends will be used for regular share buybacks.

To sum up, our mission is to follow our capital allocation strategy, acquire the right nightclubs, and make sure our guests have a great time. In turn, our success for this would lead to regular guests returning; prosperity for entertainers and our teams and company; and continued expansion and growth through increases in free cash flow per share; acquiring more clubs; share buybacks; growing our dividend; and enhancing shareholder value.

Thank you for listening. We'd be glad to take any questions at this time.

Q. Who's your competition other than the local place somewhere? Is there somebody else doing this at the corporate level the way you are? I'm familiar with your story, I'm an investor of yours, and I've been to your places.

Eric Langan - President and CEO, RCI Hospitality Holdings, Inc.

Not at a corporate level. There are a lot of mom and pop operators out there. But some own multiple clubs. For example, Déjà Vu and Spearmint Rhino.

Q: Are you in California?

Eric Langan - President and CEO, RCI Hospitality Holdings, Inc.

No. I went once. That was enough. With California laws and minimum wages up to $20 an hour in certain markets, clubs are struggling, they're not really expanding any longer. We bought a club in LA. We had it for about 18 months, and it was a nightmare. We looked at San Francisco. The problem in California is your average margins are about 24% at the top end and about 8% at the bottom. On the East Coast, where we mainly operate, and in Texas, our operating margins run closer to 40-45%. Our top clubs run more than 40-45%. Even when we have off quarters or off months, our margins are still 30% plus. So it didn't make sense to put money into a market where we were going to cap out at 24-25% when we could take that same money and put it in places where you cap out at 45% plus.

Q: You didn't have it listed in your major states, but do you do business in Nevada?

Eric Langan - President and CEO, RCI Hospitality Holdings, Inc.

We were in Vegas in 2008. It's very competitive; the barriers to entry are financial and there's so many. If you go out there and look at the clubs, I call them shrines to the owners. They build shrines. They don't build businesses. If you look at Treasures, that owner spent $28 million building that location. How could he ever get any real return on investment and return on capital on that? Almost $40 million was spent on the Hustler Club. You have to make $10, $12, $15 million in profit a year. And then you work for the cab drivers out there, paying to bring customers to the clubs. So it's a very difficult market. Now if you went to Reno or some of the other smaller markets in Nevada, those are markets we'd probably look at. We expanded recently into Colorado in '21. We're doing some more expansion in that market right now. So we are looking out West a little bit more, but we're mainly focused right now on the East Coast, Florida, New York, and then the central US as well, Illinois, Indiana, Minnesota.

Q: How deep is the management team? What's your succession plan?

Eric Langan - President and CEO, RCI Hospitality Holdings, Inc.

We're a major corporation now. We're very corporate. We have a full operational team, a subsidiary we call RCI Management Services. Ed Anakar is the president of that. We have an executive vice president Dean Reardon there. And then we have seven regional managers that work under them. Any of about four of those guys could probably run that division at any time, which is our club operation divisions. And we're constantly training. Ed's been with us 24 years. I think Dean's the newest. He's the only outsider. But he's been in the industry for going on 35 years and has been with our company for nine now. Everyone else who started with our company has worked up from whether they were a door person, floor person, or a host, and moved up into management, to general management, and then regional management. In the regionals, we averaged probably 15-18 years of experience for most of those guys.

Q: Do you have any kind of exit strategy?

Eric Langan - President and CEO, RCI Hospitality Holdings, Inc.

We're still building. I'm 56 years old. I love what I do. As they say, if you love what you do, you will never work a day in your life. I think I've worked about six days in my life because sometimes I have to go to court, and I don't really enjoy that. But other than that, I don't see myself going anywhere for at least another nine years. My son is working in the business now. He worked in the corporate office for a while out of college and now he's working in the restaurant operations division. He's actually going through the general manager training right now. I don't know what he'll eventually want to do. But there's enough young guys in our company, and when I say young, I mean they're in their 40s. But to me that's young now in our business. I'm old. I'm a relic in our business other than individual club owners that we're buying from. A lot of absentee owners are 75-80 years old. They go to their clubs at three in the afternoon, but 40% plus of their revenue is generated between 11 PM and 4 AM. None of those owners are ever in their clubs during peak hours because they're home and in bed.

But we’ve got a lot of young guys. Our regional managers are typically in their 40s, our general managers are in their 30s, and all your up and coming management are 23-30. But then I have general managers that are 65 years old, too. Some guys just love it. It's what they do. I call them grinders. They go out there and run the party at the clubs from 6:30 in the evening till 4:00 in the morning, five days a week. That's their lifestyle, and they love it. I get it because that’s what I did to build the company. I did it for a long time. The old joke in our industry used to be, oh, you don't have health insurance, you don't have 401Ks, and you don't have all the things that big companies have. But we said, yeah, but we get to hang out with all these young, beautiful women every night. Now the guys say, not only do I get to hang out with young, beautiful women, but I do have insurance. I do have a 401K. So the times have definitely changed, and we’ve become much more corporate than we were 25-35 years ago when I started.

Q: Can you speak to what's normal for Bombshells?

Eric Langan - President and CEO, RCI Hospitality Holdings, Inc.

I'm trying to get margins to 15%. Typical margins are 18-22% when everything's operating right, and we should be doing $5 million in annual revenues per unit. Right now some of our underperforming units are dragging that down. So we're in the range of $4 million with two or three. We've got to get those revenues back up.

We made major club acquisitions in ’21 and ’23. Our club division, which oversees the bar and late night side of Bombshells, got distracted because we bought 11 clubs in one transaction and six clubs in another. So we weren’t able to help Bombshells as much as we would have liked. The other Bombshells team is a restaurant team. They were doing so well, we left them alone for about three years. In ‘22 they didn't really need our help. In ’23 we made the other big club acquisition. What happened is the Bombshells team focused on the restaurant side of the business and lost that late night bar business. They promoted a lot of female managers, which is great, but then they didn't put anybody in charge of sports. They got comfortable with the DJs because they had been drawing people in, but they didn't get rid of DJs and bring in others when they needed to. The restaurant people don't understand the music format side of the bar business. That late night business was from 11 PM to 2 AM in the morning, 70% alcohol and 30% food, but the 30% food was all appetizers, which has 70% plus margins. We sell cheese sticks or nachos for $11.95 that cost us $2 to make. It's all bar food at super-high margins. So what happened is we lost all that high margin revenue and income late night.

With the restaurant part of the business, the food's great. You get service complaints like everybody, but nobody complains about our food because the food's great because we have restaurant guys running it. We've now brought the bar guys back in. We're rebuilding late night. Non-GAAP margins fell to 1% in the December quarter, then rose to 5.9% in the March quarter, and 10.8% in the June quarter. I think we’ll be somewhere in that range in this quarter. With football back, I think the October through December quarter will exceed 15% margins. Then we'll be opening at least two of the three new stores in that quarter, which will also bring margins up. But I'm more focused about the margin in same store sales than I am overall margins.

Q: Regarding the short term rental market, do you target Airbnb customers or hotels?

Eric Langan - President and CEO, RCI Hospitality Holdings, Inc.

We do more hotels. It's more of a business traveler business for us. We incentivize the concierge for every customer they send us. They get the customer into our place for discounts or they get special VIP seating, and you know the guys are with some big business convention in town or whatever. Most Airbnb and stuff tends to be more family. But we focus everywhere. We do a lot of geotag stuff now with Google, Facebook, Instagram, that type of stuff. And we target 25-50 year old males that are located within eight miles of our establishments. It's so targeted these days. You have to really know what these tech companies can do. It's incredible.

I think we've run out of time. Thanks for your questions. We can talk more in the hallway if you'd like.