

Transcript of
RCI Hospitality Holdings, Inc.
3Q24 Earnings Call
August 8, 2024¹

Participants

Eric Langan - President and CEO, RCI Hospitality Holdings, Inc.
Bradley Chhay - Chief Financial Officer, RCI Hospitality Holdings, Inc.
Mark Moran - CEO, Equity Animal

Analysts

Scott Buck – H.C. Wainwright
Jason Scheurer – Orchard Wealth Management

Presentation

Mark Moran - CEO, Equity Animal

Greetings and welcome to RCI Hospitality Holdings' Third Quarter 2024 Earnings Conference Call. You can find the company's presentation on RCI's website. Go to the Investor Relations section. All the necessary links are at the top of the page.

Please turn with me to Slide 2 of our presentation. I'm Mark Moran, CEO of Equity Animal. I'll be the host of our call. I'm coming to you from the Commonwealth of Virginia. Eric Langan, President and CEO of RCI Hospitality, and CFO Bradley Chhay are in Houston.

Please turn with me to Slide 3. RCI is making this call exclusively on X Spaces. To ask a question, you will need to join the Space with a mobile device. To listen only, you can join the Space on a personal computer. At this time, all participants are in a listen-only mode. A question-and-answer session will follow. This conference call is being recorded.

Please turn with me to Slide 4. I want to remind everybody of our Safe Harbor statement. You may hear or see forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those currently anticipated. We disclaim any obligation to update information disclosed in this call as a result of developments that occur afterwards.

Please turn with me to Slide 5. I also direct you to the explanation of RICK's non- GAAP financial measures.

Now, I'm pleased to introduce Eric Langan, President and CEO of RCI Hospitality. Eric, take it away.

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

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

Thank you. If everyone will turn to Slide 6, I'd like to thank you for joining us today.

We made a lot of progress during the third quarter. It reflects the first full quarter of our Back to Basics approach to our business and our Capital Allocation Strategy.

Specifically, we are taking aggressive actions to increase revenues, reduce costs, and expand margins. We're concentrating on our core club business, improving the Bombshells, and buying back shares, all with the goal of increasing free cash flow per share.

Yes, we had a lot of impairment that affected our GAAP results in the third quarter, but that was non-cash. The key takeaways are that Nightclubs achieved record revenues with a year-over-year increase in total sales and the first quarter of year-over-year increase in same-store sales since the second quarter of fiscal '23. Sales also increased from the last quarter.

Bombshells sales increased sequentially and margins grew from 5.9% last quarter to 10.8% this quarter, reflecting our Back to the Basics approach starting in February of 2024.

Looking at our list of new projects, we have opened, converted, or enhanced seven locations to date this fiscal year, and we are working on opening, reopening, or reformatting seven more as fast and efficiently as possible. As part of this effort, we formally withdrew our application for Colorado casino licenses to better focus on projects that will provide more immediate results.

Looking at our Capital Allocation Strategy, we added \$20 million to our war chest through a bank real estate loan. The Board of Directors authorized increasing the amount available under our share repurchase program by \$25 million. And we took advantage of our low stock price during the third and fourth quarters. To that end, I'm pleased to announce we have reached our short term objective of reducing shares outstanding to less than 9 million.

Please turn to Slide 7. I'm also pleased to announce that as part of our share buyback program, we bought back 700,000 shares in the open market, reducing our share count by the same number we used in our big October '21 and March '23 acquisitions. As you will see on this slide, we bought back those 700,000 shares at a 22% discount to the average share price used in those transactions.

Please turn to Slide 8. Over the last few years, we have achieved some major accomplishments. We more than survived COVID. We then managed through the post-COVID bounce. Then we made our two biggest acquisitions ever, successfully integrated them, and improved their results.

Now that things have settled down, and given the uncertain economic environment, we want to take a good, hard look at what we should do next to best increase free cash flow per share and return value to our investors. We are now working on a five-year strategic plan. We plan to implement it starting in fiscal 2025 and tell you more about it on our next earnings call.

Here's a general outline. Right now, we see two pillars to the plan. The first is to continue our Back to the Basics approach to our business. We want to make sure our locations are running as

efficiently and profitably as possible. Our priorities would be to grow same-store sales, improve margins, and rebrand and reformat underperforming locations or sell them.

The second pillar is Capital Allocation. Assuming no growth, we should have approximately \$250 million of free cash flow to deploy. Our priorities would be to target less than 10% of discretionary free cash flow to ensure a stable and modestly growing dividend; target about 50% of discretionary free cash flow for selective M&A, focusing on base hits and the occasional home run, making sure we capture synergies at the acquired clubs; and to target any excess cash not used in M&A and dividends for regular share buybacks.

Now, here's Bradley.

Bradley Chhay - Chief Financial Officer, RCI Hospitality Holdings, Inc.

Thanks, Eric.

Please turn to Slide 9. The core strength of our business enabled us to generate \$76.2 million in revenue in the third quarter. GAAP EPS was a loss of \$0.56 per share. This primarily reflected non-cash impairment of \$17.9 million in the current quarter. A good portion of that is related to the impairment of right-of-use and leasehold improvements on several operating leases. On a non-GAAP basis, EPS totaled \$1.35. In addition, free cash flow reached a year high of \$13.8 million, as did adjusted EBITDA at \$20.1 million.

Please turn to Slide 10. Nightclubs revenues of \$62.8 million increased \$374,000 year-over-year. This primarily reflected same-store sales growth of 1.7%, two new and reformatted clubs, and a strong pro sports playoff line-up in May. In turn, this was partially offset by some temporary closings of clubs being reformatted to liquor from BYOB and severe weather in Texas and South Florida.

By revenue type, alcoholic beverages increased 4.9%; food, merchandise, and other increased by 5.1%; and service revenue decreased by 5.3%. The differing growth rates primarily reflected a higher alcohol and lower service revenue mix from clubs acquired in the past year and a half.

Non-cash impairment of \$7.6 million in goodwill, SOB, and leasehold improvement impairments related to six clubs.

GAAP operating income was \$13.6 million, compared to \$20.4 million, with a margin of 21.7% of revenues, compared to 32.7%. Non-GAAP operating income was \$21.9 million, compared to \$23.6 million, with a margin of 34.9%, compared to 37.7%.

Comparing to the last quarter, revenues increased 5.8%, non-GAAP operating income increased 10.5%, and margin increased to 34.9% from 33.4%. All of these improvements reflected higher sales, including service, and reduced costs.

Please turn to Slide 11. Bombshells revenues of \$13.1 million declined by 8.7%. This primarily reflected reduced same-store sales and temporary closings due to severe weather in Texas. In turn,

this was partially offset by three locations not in same-store sales: Bombshells San Antonio and Stafford in Texas, and Cherry Creek Food Hall and Brewery in Colorado, with its Bombshells Kitchen.

The strong pro sports playoff line-up in May also helped. Non-cash impairment of \$10.3 million reflected operating lease right-of-use asset impairment and leasehold improvement impairment related to five Bombshells.

GAAP operating results were a loss of \$8.9 million, compared to an income of \$1.7 million, with a margin of negative 67.8% of revenues compared to 11.8%. Non-GAAP operating income was \$1.4 million, compared to \$1.8 million, with a margin of 10.8%, compared to 12.8%.

Compared to last quarter, however, revenues increased 2.9%, non-GAAP operating income increased 89.3%, and margin increased to 10.8% from 5.9%. These improvements reflect the first full quarter of changes initiated in mid-February 2024.

Please turn to Slide 12. We've made some progress on reducing corporate expenses. Year-over-year, they were 9.4% of total revenues, compared to 8.1%. But compared to last quarter, they were level at 9.4% on a GAAP basis. On a non- GAAP basis, they were 8.4%, compared to 8.8%.

Please turn to Slide 13. This slide puts our operating performance into perspective, looking at the third quarter compared to the second quarter, so you can see how results improved on a non-GAAP basis.

We also added some data on the number of location day closures for club and Bombshells during the third quarter due to severe weather. During the third quarter, we had one day closure for clubs and 10 for Bombshells. To date in the fourth quarter, we've had 10 day closures for clubs and 26 for Bombshells, all in Houston due to Hurricane Beryl.

Please turn to Slide 14. We have a couple of slides coming up that discuss free cash flow and adjusted EBITDA, which are non-GAAP. In advance of that, we wanted to present the closest GAAP equivalents on this slide, which are operating and net income.

Please turn to Slide 15. We ended the third quarter with cash and cash equivalents of \$34.9 million. This included proceeds from our \$20 million bank real estate loan. During the quarter, we used \$9.2 million to buy back shares. As a percentage of revenues, free cash flow was 18% and adjusted EBITDA was 26%, both highs year-to-date.

Please turn to Slide 16. Debt at June 30 increased by \$13.5 million from March 31st. This reflected a combination of the new bank loan and scheduled pay downs. The weighted average interest rate was 6.74%, only 22 basis points higher than a year ago.

Total occupancy costs at 7.9% declined from 8% year-over-year and on a sequential quarter basis. Debt to trailing 12-month adjusted EBITDA increased to \$3.27, primarily due to the new bank loan. This should decline over the coming year as sales grow from locations that have come online recently and from those anticipated to open.

Debt maturities continue to remain reasonable and manageable. Subsequent to the quarter, we paid down \$1.5 million on the Playmate note and extended the balance 16 months out. The balloon payment at the extended maturity date was adjusted accordingly. The monthly installment payment and principal and interest have remained unchanged.

Please turn to Slide 17. We continue to pay down all slices of our debt with the exception of real estate because of the new bank loan. As a result, that slice is larger at 61.4%. All the other slices are proportionately lower adjusted for their net debt pay downs.

Now, let me turn the presentation over back to Eric.

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

Thanks, Bradley.

Please turn to Slide 18. I want to make clear that everything we do is centered around our Capital Allocation Strategy. We employ three different approaches subject to whether there is compelling rationale to do otherwise. Mergers and acquisitions, organic growth, or buying back shares when the yield on our free cash flow per share is more than 10%.

Please turn to Slide 19. With that in mind, we are laser-focused on opening the seven reformatted and new clubs and Bombshells currently under development; rebuilding the Baby Dolls Fort Worth location that burnt down in July as fast and efficiently as possible; reviewing all operating units to ensure they meet our financial objectives; selling non-income producing real estate to free up more cash and reduce debt; and using free cash flow to facilitate the buyback of more shares and acquisitions of clubs.

Please turn to Slide 20. By sticking to our Capital Allocation Strategy since the end of fiscal 2015, we have generated compound annual growth rates of 10.2% for total revenues, 12.1% for adjusted EBITDA, and 17.2% for free cash flow. We have also reduced our fully diluted share count.

I'd like to give special thanks to our loyal and dedicated teams for all their hard work and effort in this past quarter and for all our shareholders who believe and make our success possible.

Mark Moran - CEO, Equity Animal

Thank you, Eric and Bradley. To start things off, we'd like to take questions from RICK's analyst and then some of its larger shareholders. First off, we have Scott Buck of HC Wainwright. Scott, take it away.

Q: Hi. Good afternoon, guys. Thanks for taking my questions. Nice progress on the Bombshells margins. I'm curious, if we use the baseball analogy of what inning you're in, how far along are we in the restructuring process there and can we get those margins back to 20%?

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

Right now my goal is 15% for sure. I'd like to see us getting back to the deals. Using a baseball analogy, I'd probably say we're in the fifth inning, probably the bottom of the fifth. We're headed into that seventh inning stretch, which I think will be in September, and then heading towards the finals in October, November, December, where I believe that we'll certainly hit the 15% and maybe better as we open new stores and move into calendar 2025, second quarter of our fiscal year. Then we might get back up to those 20% margins. We just have to see how these new stores do. They're all handpicked flagship locations, and I'm very excited about those locations. So, we will see.

We may also consider as we move forward through the end of September of maybe even taking some underperforming locations and either selling those locations off or closing some of those locations as well. I know a lot of restaurant chains have been doing that. I've been looking at the numbers on a couple of underperforming locations, and it may just make more sense at this point to eliminate those locations versus continuing to put the efforts in to fix them and taking those efforts and put them on others. We'll come up with those decisions over the next probably 45 to 60 days.

Q: Great. I appreciate that color. And Eric, I think you were in the upper Midwest a few weeks back, checking out some clubs. Can you give us an update on what the environment is for M&A and maybe a reminder of what it is you guys are looking for in a club property?

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

We've been getting lots of calls. We went to the Detroit market. It's a market we're not in. There're some very successful clubs in that market. We've been told some of those are for sale. We're actually talking and meeting with some of those owners this weekend and probably through next week, and hopefully by EXPO, we will meet some. Some of them are coming to the EXPO as well as other club owners we've been talking with.

The pipeline has really heated up. People are starting to get more reasonable. They're starting to realize that 2022 was a one-time event for the industry and realizing that going into '23, '24, '25, a more reasonable number to sell their clubs versus those high earnings from 2022. And so, I'm very optimistic that going forward over the next 12 to 24 months we're going to see some nice acquisitions coming forward at a closer to 5x multiple with real estate included.

Q: Great. That's helpful. And then I want to ask about the Colorado properties. I think you're still full go on the steakhouse, but the other properties you have there, what's the timeline to liquidate or do you have something else in mind?

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

We're talking with several people. We may lease those properties. We may sell those properties. We've got several groups. With one particular property, I expect an LOI on that property probably in the next few weeks, if not sooner. The other property, we're talking with several people. It's got

a tenant in it right now, but there's additional space in there. So we may add additional tenants to that or we may sell that property if we find the right casino operator to sell that property to.

As for the Rick's Cabaret Steakhouse property, we'll open that property. I'm hoping to make October. If we don't make October, it's very difficult to open in full winter up there. So, we may push that to a spring opening or we may do maybe some temporary, like weekend-only opening or something like that. I haven't really got a full plan because right now I'm planning to get be finished by October, but unfortunately construction is out of my hands. It's going to be whether they can get it done in time for us to do that. That's currently the plan on that one.

Q: Great. That's helpful. And then last question, Bradley, should we see a meaningful decline in interest rates? Are there any opportunities for potential refinancing that could help with cash flow?

Bradley Chhay - Chief Financial Officer, RCI Hospitality Holdings, Inc.

As of right now there, you're seeing what I'm seeing as far as the news media. I have spoken to the bank yesterday and there's nothing immediately in the future for us to refinance or anything like that, but we're closely watching that because we've got quite a bit of debt that we're trying to lower our interest rate and debt service on.

Q: Great. That's helpful, guys. I appreciate the time. Thank you.

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

Thank you.

Mark Moran - CEO, Equity Animal

Thanks so much, Scott. Next up, we have Jason Scheurer of Orchard Wealth. Please, take it away.

Q: You guys said \$10 million on the share buybacks from the clubs that you purchased. And I'm assuming, I forgot what the old things were, but you paid about 5x earnings for both Colorado and for Chicas Locas, right?

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

The club purchases were 5x plus the real estate on the Colorado acquisition, and I believe we were 4x plus the real estate on the Burch acquisition, which is Baby Dolls and Chicas Locas.

Q: Right. And then since you guys have taken over those properties, you've seen improvements from what their sales numbers were before, correct?

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

Yes. Definitely.

Q: The idea being is you guys have been able to up the earnings on the clubs for what you paid and then what you paid, you guys have been able to get for 22% lower. Or if it was a 5x, it was like a 4.2x, in terms of what you paid for it, now that you've adjusted the new prices, right?

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

It was 22% less stock, not the total purchase price. It depends on how you want to look at it. If you split the baby, say you take \$5 million less on each, we only paid \$83 million for the Colorado acquisition and we only paid \$61 million for the Baby Dolls acquisition. You can go and figure out those multiples that way. That's how I would do it. But, yes, but it's still a considerable savings on the overall deal. And the nice thing is, is on a free cash flow per share basis, all those shares are no longer outstanding yet we have all that new revenue coming in.

Q: Great. It seems like the majority of the shares you basically took down when the stock broke below like \$45. There was like a huge amount of shorts that came into the market in the last, let's say five to six weeks max, where it looks like they put on 500,000 shares, bringing the total to 925,000 shares that are outstanding, that are going to have to buy it back. So, you were the guys buying those shorts.

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

If you look at the last two months, we probably bought over 50% of the shares. We had 400,000 one quarter, 133,000 so far this quarter. So, we probably bought 250,000 or more of those shares in basically June and July. And we made some very large purchases when the stock went under \$40. It wasn't for very long. It was only a few days, but we were buying about the maximum amount of shares. I think we could buy on a couple of those days when it was under \$40 down to \$38 and change, I think. I'd say under \$42, we bought pretty heavily. And then we just bought an average of between \$42 and \$50. We just bought basically a pretty much steady number of shares every day, occasionally bumping it up because we set a target, an internal target of being under 9 million shares by August 5. So, we were buying the shares we needed to buy, basically taking the total number we needed, dividing it by the number of trading days left. And so, we were buying 3,000 shares a day, 5,000 shares a day, or if we couldn't get stock, some days we didn't get stock. And I think for a brief period, we were buying probably 8,000 shares a day, and then got it back to a normalized number and dropped it down again.

Q: Okay. Then my last question would be, obviously, this Bear Cave dude put out this tweet and it was a picture of some people standing in front of the clubs or whatever. Can you comment on any of this BS stuff that they were trying to make it seem like you guys were up to no good with whatever that police thing was about?

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

I would refer you to the 10-Q and the disclosures in the 10-Q and state that I cannot make any comments on any type of ongoing investigations at this time, but there are disclosures in the 10-Q, if you want to see what that is. And you'll see that he was a little off base on a lot of the accusations that he made.

Q: A little bit or a lot of bit. All right. Great. I'm just blown away by the fact that you guys were able to save \$10 million on the purchase price. That's like massive.

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

Yeah. Thank you. I mean, it was very important to me, too.

Mark Moran - CEO, Equity Animal

Perfect. So, next up, we're going to bring up "Wawaywewhy @BiotechSacred". Can you hear me?

Q: Okay. Great. Thank you. Thanks for the opportunity. So curious, just cumulatively, how much cash has been invested in the Bombshells business and the casinos?

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

Casino properties and remodel of the Rick's Cabaret, there's about \$6 million in non-income producing properties up there, and we'll have about \$8 million invested in the Rick's Cabaret and Steakhouse that will actually open. We have one of the properties for sale right now for \$5 million, and I think we'll get an LOI on it. I don't know if we'll get a full asking price, but I think we'll be very close. So, we'll have recouped almost 100% of the non-income producing properties will be almost recouped other than the one property, but we have a tenant, so it's actually income producing. I shouldn't really say it's non-income producing. It is income producing, just not a significant amount. And then when the Rick's opens, I think we'll recoup that investment pretty quickly.

But a lot of that is debt now, because when we did the \$20 million loan, those three properties are a big portion of the collateral on the \$20 million loan, so we actually got our cash back. So, to do a true cash on cash, I'll have to have Bradley do a calculation on it. I haven't been that concerned with it because it wasn't really material in the overall investment from the company right now.

As far as Bombshells goes, I know in June of 2023 we were 140% cash on cash returned for Bombshells. Where we're at today, I haven't run that again recently, but I know we have invested 40% of the first 13 stores into these next three stores, so we're still probably 100% cash on cash or more has been returned to us. We've only invested profits that Bombshells has made in the past into the concept, and we're nowhere near the amount of full profits. So, on that basis, you're probably talking from an ROI standpoint, we have really no money invested in the concept and we made \$1.4 million off Bombshells this past quarter. If we get back to where I think we need to be, which is about \$15 million in revenue a quarter and 15% margins, we'll still be making a significant amount of money off Bombshells, and we can look to take those assets and monetize them in another way and then reinvest that money back into our adult club business.

Q: Okay. Thank you. I have no more questions. Thank you.

Mark Moran - CEO, Equity Animal

Hey, Eric, we have an anonymous question submitted. If you'd like to discuss the fire that happened?

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

We don't know what happened. It was inconclusive results on the fire investigation. That building was completely remodeled in 2023. We believe it was some type of electrical fire based on where the fire burned through the roof and which walls collapsed first. Where the hottest part of the fire was at, it was in that electrical room area. There was no kitchen, real kitchen there. There's no natural gas there. So, couldn't have been a gas leak or anything.

So, when you eliminate all those things, the last person that left the building was a cleaning crew at 4:40 a.m. in the morning according to the alarm system. It's just one of those freak things. It's a rough loss for us because it was up to about \$80,000 a week in sales. The club was doing very well. It was newly remodeled. It's a tough deal, but we've already started the cleanup. We hired the architect within three days of the fire and started redesigning the property to be rebuilt in an image of the new Baby Dolls West Fort Worth location that we're building. So, we'll be moving along pretty quickly there and get that back open for us.

Mark Moran - CEO, Equity Animal

Fantastic. And with that, on behalf of Eric, Bradley, the company, and our subsidiaries, thank you and have a good night. As always, please visit one of our clubs or restaurants and have a great time.