

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 March 31, 2016

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.)

10959 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

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 April 30, 2016, 9,889,166 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, in 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 affects on our financial condition and results of operations include, but are not limited to, the risks and uncertainties related to our future operational and financial results, operating and managing adult businesses, competitive factors, conditions relevant to real estate transactions, cybersecurity, the timing of the openings of other clubs, the availability of acceptable financing to fund corporate expansion efforts, our dependence on key personnel, the ability to manage operations and the future operational strength of management, and the laws governing the operation of adult entertainment businesses. 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,” “RCIHH,” “we,” “our,” and similar terms include RCI Hospitality Holdings, Inc. and its subsidiaries, unless the context indicates otherwise.

RCI HOSPITALITY HOLDINGS, INC.
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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

ASSETS

(in thousands, except per share data)	March 31, 2016 (UNAUDITED)	September 30, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 9,055	\$ 8,020
Accounts receivable:		
Trade, net	2,091	1,578
Other, net	608	576
Marketable securities	-	614
Inventories	2,738	2,368
Prepaid expenses and other current assets	3,154	4,010
Total current assets	17,646	17,166
Property and equipment, net	144,454	134,150
Other assets:		
Goodwill	52,641	52,641
Indefinite lived intangibles, net	55,728	55,828
Definite lived intangibles, net	4,626	5,021
Other	1,375	2,224
Total other assets	114,370	115,714
Total assets	\$ 276,470	\$ 267,030

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

(in thousands, except per share data)	March 31, 2016 <u>(UNAUDITED)</u>	September 30, 2015
<hr/>		
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 2,109	\$ 2,164
Accrued liabilities	8,301	9,626
Texas patron tax liability	1,254	1,364
Current portion of long-term debt	8,755	9,700
Total current liabilities	<u>20,419</u>	<u>22,854</u>
Deferred tax liability	28,897	28,087
Other long-term liabilities	2,279	2,723
Long-term debt	92,958	84,880
Total liabilities	<u>144,553</u>	<u>138,544</u>
Commitments and contingencies		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.10 par, 1,000 shares authorized; none issued and outstanding	-	-
Common stock, \$.01 par, 20,000 shares authorized; 9,858 and 10,285 shares issued and outstanding, respectively	99	103
Additional paid-in capital	66,019	69,729
Accumulated other comprehensive income	-	109
Retained earnings	60,443	52,682
Total RCIHH stockholders' equity	<u>126,561</u>	<u>122,623</u>
Noncontrolling interests	5,356	5,863
Total stockholders' equity	<u>131,917</u>	<u>128,486</u>
Total liabilities and stockholders' equity	<u>\$ 276,470</u>	<u>\$ 267,030</u>

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)	FOR THE THREE MONTHS ENDED MARCH 31,		FOR THE SIX MONTHS ENDED MARCH 31,	
	2016	2015	2016	2015
	(UNAUDITED)		(UNAUDITED)	
Revenues:				
Sales of alcoholic beverages	\$ 14,581	\$ 14,311	\$ 29,178	\$ 28,316
Sales of food and merchandise	4,609	4,837	8,943	9,670
Service revenues	13,205	13,847	25,846	27,376
Other	2,001	1,994	3,904	3,832
Total revenues	<u>34,396</u>	<u>34,989</u>	<u>67,871</u>	<u>69,194</u>
Operating expenses:				
Cost of goods sold	5,227	5,381	10,411	10,492
Salaries and wages	7,917	8,115	16,052	16,147
Stock compensation	120	120	240	240
Other general and administrative:				
Taxes and permits	3,274	3,288	6,501	6,399
Charge card fees	557	544	1,170	1,091
Rent	859	1,184	1,807	2,325
Legal and professional	982	1,064	2,087	2,023
Advertising and marketing	1,225	1,312	2,530	2,679
Insurance	907	801	1,781	1,621
Utilities	694	708	1,404	1,442
Depreciation and amortization	1,826	1,886	3,643	3,531
(Gain) loss on sale of property and marketable securities	(127)	(18)	(127)	(18)
Impairment of assets	-	-	-	1,358
Settlement of lawsuits and other one-time costs	62	10,303	602	10,550
Other (Note 16)	3,323	2,917	6,503	5,790
Total operating expenses	<u>26,846</u>	<u>37,605</u>	<u>54,604</u>	<u>65,670</u>
Operating income (loss)	7,550	(2,616)	13,267	3,524
Other income (expense):				
Interest income	1	26	3	39
Interest expense	(1,965)	(1,783)	(3,878)	(3,402)
Gain from acquisition of controlling interest in subsidiary	-	-	-	577
Income (loss) before income taxes	5,586	(4,373)	9,392	738
Income taxes (benefit)	293	(1,265)	1,660	581
Net income (loss)	5,293	(3,108)	7,732	157
Less: net loss attributable to noncontrolling interests	212	267	325	362
Net income (loss) attributable to RCI Hospitality Holdings, Inc.	<u>\$ 5,505</u>	<u>\$ (2,841)</u>	<u>\$ 8,057</u>	<u>\$ 519</u>
Basic earnings (loss) per share attributable to RCIHH shareholders:				
Net income	\$ 0.55	\$ (0.28)	\$ 0.79	\$ 0.05
Diluted earnings (loss) per share attributable to RCIHH shareholders:				
Net income	\$ 0.54	\$ (0.28)	\$ 0.78	\$ 0.05
Weighted average number of common shares outstanding:				
Basic	10,013	10,275	10,154	10,269
Diluted	10,215	10,275	10,356	10,273
Dividends per share	\$ 0.03	\$ -	\$ 0.03	\$ -

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share data)	FOR THE THREE MONTHS ENDED MARCH 31,		FOR THE SIX MONTHS ENDED MARCH 31,	
	2016	2015	2016	2015
	(UNAUDITED)		(UNAUDITED)	
Net income (loss)	\$ 5,293	\$ (3,108)	\$ 7,732	\$ 157
Amounts reclassified from accumulated other comprehensive income	(109)	-	-	-
Other comprehensive income:				
Unrealized holding gain (loss) on securities available for sale	-	5	-	13
Comprehensive income (loss)	5,184	(3,103)	7,732	170
Comprehensive (income) loss attributable to noncontrolling interests	212	267	325	362
Comprehensive income (loss) to common stockholders	\$ 5,396	\$ (2,836)	\$ 8,057	\$ 532

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, except per share data)

FOR THE SIX MONTHS
ENDED MARCH 31,
2016 2015
(UNAUDITED)

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 7,732	\$ 157
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	3,643	3,531
Deferred taxes	786	1,461
Impairment of assets	-	1,358
Amortization of note discount	10	33
(Gain) on sale of marketable securities and from acquisition of controlling interest in subsidiary	(127)	(577)
Deferred rents	(446)	(16)
Beneficial conversion	5	5
Stock compensation expense	240	240
Changes in operating assets and liabilities:		
Accounts receivable	(545)	(2,844)
Inventories	(370)	(428)
Prepaid expenses and other assets	1,719	2,782
Accounts payable and accrued liabilities	(1,535)	7,417
Cash provided by operating activities	<u>11,112</u>	<u>13,119</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(13,561)	(2,869)
Proceeds from sale of marketable securities	628	-
Acquisition of businesses, net of cash acquired	-	(1,244)
Net cash used by investing activities	<u>(12,933)</u>	<u>(4,113)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(7,553)	(8,234)
Proceeds from long-term debt	15,517	4,958
Payments of dividends	(296)	-
Purchase of treasury stock	(4,704)	(1,925)
Distribution to noncontrolling interests	(108)	(108)
Cash provided by (used in) financing activities	<u>2,856</u>	<u>(5,309)</u>
NET INCREASE IN CASH	1,035	3,697
CASH AT BEGINNING OF PERIOD	8,020	9,964
CASH AT END OF PERIOD	<u>\$ 9,055</u>	<u>\$ 13,661</u>
CASH PAID DURING PERIOD FOR:		
Interest	<u>\$ 3,896</u>	<u>\$ 3,078</u>
Income taxes	<u>\$ 97</u>	<u>\$ 1,724</u>

See accompanying notes to consolidated financial statements.

Non-cash transactions and other:

On March 31, 2016, a related party creditor converted \$750,000 of debt to 75,000 shares of the Company's common stock.

During the six months ended March 31, 2016, the Company purchased and retired 500,902 common treasury shares. The cost of these shares was \$4.7 million.

During the six months ended March 31, 2015, the Company incurred \$1.4 million in seller-financed long-term debt in connection with the acquisition of real estate.

During the six months ended March 31, 2015, the Company converted debt principal and interest valued at \$1.8 million into 177,018 common shares.

During the six months ended March 31, 2015, the Company purchased and retired 192,427 common treasury shares. The cost of these shares was \$1.9 million.

During the six months ended March 31, 2015, the Company issued 200,000 shares of common stock for the acquisition of a controlling interest in Drink Robust, Inc.

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2016
(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“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 accounting principles generally accepted in the United States of America for complete financial statements. 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, 2015 included in the Company’s Annual Report on Form 10-K, as filed with the Securities and Exchange Commission. The interim unaudited financial statements should be read in conjunction with those financial statements included in the Form 10-K. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting solely of normal recurring adjustments, have been made. Operating results for the six months ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending September 30, 2016.

2. RECENT ACCOUNTING STANDARDS AND PRONOUNCEMENT

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 is effective for annual periods beginning after December 15, 2016, and interim periods therein, 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). The Company is still evaluating the effect of this standard on the consolidated financial statements.

In the accompanying statements of income, the Company has reported revenues for the quarter ended March 31, 2016 and 2015 net of sales taxes and other revenue related taxes, due to a change in accounting policy. Previously, the Company had included these taxes in revenue and expense.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements — Going Concern (Subtopic 205-40)* . The purpose of this ASU is to incorporate into U.S. GAAP management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable), and to provide related footnote disclosures. This update is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The adoption of this guidance will not have a material impact on the Company’s consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, *Compensation—Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (a consensus of the FASB Emerging Issues Task Force)* . This ASU clarifies that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting to account for such awards. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. This ASU is effective for annual periods, and interim periods within those years, beginning after December 15, 2015. Early adoption is permitted. This ASU may be applied either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. The adoption of this guidance will not have a material impact on the Company’s consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs* , which amends FASB ASU Subtopic 835-30, *Interest - Imputation of Interest* . The new standard requires that all costs incurred to issue debt be presented in the balance sheet as a direct deduction from the carrying value of the debt. The standard is effective for interim and annual periods beginning after December 31, 2015 and is required to be applied on a retrospective basis. Early adoption is permitted. The Company has early-adopted this guidance as of December 31, 2015.

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2016
(UNAUDITED)

2. RECENT ACCOUNTING STANDARDS AND PRONOUNCEMENTS – continued

In February 2015, the FASB issued ASU No. 2015-02, which amends FASB ASU Topic 810, *Consolidations*. This ASU amends the current consolidation guidance, including introducing a separate consolidation analysis specific to limited partnerships and other similar entities. This ASU requires that limited partnerships and similar legal entities provide partners with either substantive kick-out rights or substantive participating rights over the general partner in order to be considered a voting interest entity. The specialized consolidation model and guidance for limited partnerships and similar legal entities have been eliminated. There is no longer a presumption that a general partner should consolidate a limited partnership. For limited partnerships and similar legal entities that qualify as voting interest entities, a limited partner with a controlling financial interest should consolidate a limited partnership. A controlling financial interest may be achieved through holding a limited partner interest that provides substantive kick-out rights. The standard is effective for annual periods beginning after December 15, 2015. The Company is currently evaluating the standard, but does not, at this time, anticipate a material impact to the financial statements and footnote disclosures once implemented.

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 first-in, first-out (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 and 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 adoption of this guidance by the Company is not expected to have a material impact on its consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, *Simplifying the Accounting for Measurement-Period Adjustments*. The ASU requires an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. Acquirers must recognize, in the same reporting period, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. This ASU is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The adoption of this guidance by the Company is not expected to have a material impact on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, *Balance Sheet Classification of Deferred Taxes*. The ASU requires entities to classify deferred tax liabilities and assets as noncurrent in a classified statement of financial position. This ASU is effective for fiscal years beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for all entities as of the beginning of an interim or annual reporting period. As explained below, the Company has early-adopted this guidance.

3. RECLASSIFICATIONS

In the accompanying statements of income, the Company has reported revenues for the quarter ended March 31, 2016 and 2015 net of sales taxes and other revenue related taxes, due to a change in accounting policy. Previously, the Company had included these taxes in expense. The reclassifications amounted to \$2.1 million and \$2.1 million and \$4.7 million and \$4.7 million for the quarters and six months ended March 31, 2016 and 2015, respectively.

In the accompanying balance sheet, the Company has reported deferred tax assets and liabilities and assets as of March 31, 2016 and 2015 as a net item in accordance with ASU 2015-17 explained above. Previously, these balance sheet accounts had been reported gross as assets and liabilities.

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2016
(UNAUDITED)

3. RECLASSIFICATIONS – continued

This change resulted in a reclassification of \$2.9 million and \$3.4 million from current assets to long-term liabilities as of March 31, 2016 and September 30, 2015, respectively.

In the accompanying balance sheet, the Company has reported deferred debt issue costs as a reduction of long-term debt as of March 31, 2016 and 2015, in accordance with ASU 2015-03 explained above. Previously these balance sheet accounts had been reported as other assets. This change resulted in a reclassification of \$418,255 and \$339,856 from long-term assets to long-term liabilities as of March 31, 2016 and September 30, 2015, respectively.

4. SIGNIFICANT ACCOUNTING POLICIES

Following are certain significant accounting principles and disclosures.

Fair Value Accounting

The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels.

GAAP establishes a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

- Level 1 – Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Include other inputs that are directly or indirectly observable in the marketplace.
- Level 3 – Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

We classify our marketable securities as available-for-sale, which are reported at fair value. Unrealized holding gains and losses, net of the related income tax effect, if any, on available-for-sale securities are excluded from income and are reported as accumulated other comprehensive income in stockholders' equity. Realized gains and losses from securities classified as available for-sale are included in comprehensive income. We measure the fair value of our marketable securities based on quoted prices for identical securities in active markets, or Level 1 inputs. As of March 31, 2016, we reported no available-for-sale securities.

In accordance with GAAP, we review our marketable securities to determine whether a decline in fair value of a security below the cost basis is other than temporary. Should the decline be considered other than temporary, we write down the cost basis of the security and include the loss in current earnings as opposed to an unrealized holding loss. No losses for other than temporary impairments in our marketable securities portfolio were recognized during the quarter ended March 31, 2016.

Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis – continued

Financial assets and liabilities measured at fair value on a recurring basis are summarized below:

(in thousands) March 31, 2016,	Carrying Amount	Level 1	Level 2	Level 3
Marketable securities	\$ -	\$ -	\$ -	\$ -

(in thousands) September 30, 2015	Carrying Amount	Level 1	Level 2	Level 3
Marketable securities	\$ 614	\$ 614	\$ -	\$ -

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2016
(UNAUDITED)

4. SIGNIFICANT ACCOUNTING POLICIES - continued

Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities that are measured at fair value on a nonrecurring basis relate primarily to tangible fixed assets, goodwill and other intangible assets, which are remeasured when the derived fair value is below carrying value in the Consolidated Balance Sheets. For these assets, the Company does not periodically adjust carrying value to fair value except in the event of impairment. If it is determined that impairment has occurred, the carrying value of the asset is reduced to fair value and the difference is recorded within income before interest, other income (expense) and income taxes in the consolidated statements of income.

(in thousands) Description	March 31 2016	Fair Value at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Asset (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Goodwill	\$ 52,641	\$ -	\$ -	\$ 52,641
Property and equipment, net	144,454	-	-	144,454
Indefinite lived intangibles	55,728	-	-	55,728
Definite lived intangibles, net	4,626	-	-	4,626

(in thousands) Description	September 30 2015	Fair Value at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Asset (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Goodwill	\$ 52,641	\$ -	\$ -	\$ 52,641
Property and equipment, net	134,150	-	-	134,150
Indefinite lived intangibles	55,828	-	-	55,828
Definite lived intangibles, net	5,021	-	-	5,021

(in thousands) Description	Total Gains (Losses) Quarters Ended March 31,	
	2016	2015
Goodwill	\$ -	\$ -
Property and equipment, net	-	-
Indefinite lived intangibles	(100)	-
Definite lived intangibles, net	-	-

5. STOCK OPTIONS AND STOCK-BASED EMPLOYEE COMPENSATION

Employee and Director Stock Option Plans

In 1995, the Company adopted the 1995 Stock Option Plan (the “1995 Plan”) for employees and directors. In August 1999, the Company adopted the 1999 Stock Option Plan (the “1999 Plan”) and in 2010, the Company’s Board of Directors approved the 2010 Stock Option Plan (the “2010 Plan”) (collectively, “the Plans”). The 2010 Plan was approved by the shareholders of the Company at the 2011 Annual Meeting of Shareholders. The options granted under the Plans may be either incentive stock options, or non-qualified options. The Plans are administered by the Board of Directors or by a compensation committee of the Board of Directors. The Board of Directors has the exclusive power to select individuals to receive grants, to establish the terms of the options granted to each participant, provided that all options granted shall be granted at an exercise price not less than the fair market value of the common stock covered by the option on the grant date and to make all determinations necessary or advisable under the Plans.

The compensation costs recognized for each of the six month periods ended March 31, 2016 and 2015 were \$240,024, related to restricted stock. There were no stock option grants or exercises for the three month periods ended March 31, 2016 and 2015. There was no unamortized stock compensation expense related to stock options at March 31, 2016.

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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5. STOCK OPTIONS AND STOCK-BASED EMPLOYEE COMPENSATION - continued

Stock Option Activity

There were no stock options outstanding at March 31, 2016, and there were no stock option transactions nor expense for the three months ended March 31, 2016 and 2015.

6. GOODWILL AND OTHER INTANGIBLES

Following are the changes in the carrying amounts of goodwill and licenses for the six months ended March 31, 2016 and 2015:

(in thousands)	2016			2015		
	Definite-Lived Intangibles	Licenses	Goodwill	Definite- Lived Intangibles	Licenses	Goodwill
Beginning balance	\$ 5,021	\$ 55,828	\$ 52,641	\$ 729	\$ 53,968	\$ 43,374
Intangibles acquired	-	-	-	10,375	3,565	-
Impairment	-	-	-	-	(1,358)	-
Amortization and other	(395)	(100)	-	(633)	-	51
Ending balance	<u>\$ 4,626</u>	<u>\$ 55,728</u>	<u>\$ 52,641</u>	<u>\$ 10,471</u>	<u>\$ 56,175</u>	<u>\$ 43,425</u>

During the six months ended March 31, 2015, we recorded an impairment of \$1.4 million for the indefinite-lived intangible assets at our Temptations Cabaret in Lubbock.

7. LONG-TERM DEBT

On March 31, 2016, a related party creditor converted \$750,000 of debt to 75,000 shares of the Company's common stock.

On January 13, 2016, a subsidiary of the Company acquired the land and building in Manhattan where Rick's Cabaret New York is located. Total consideration was \$10.0 million for the land and the three-story, 14,000 square foot building at 50 West 33rd Street. The acquisition was wholly financed through a 5.0% bank loan, with a 25 year amortization and 10 year balloon.

In October 2015, the Company refinanced certain real estate debt amounting to \$2.3 million with new bank debt of \$4.6 million. After closing costs, the Company received \$2.0 million in cash from the transaction. The new debt is payable \$30,244 per month, including interest at 5.0% and matures in ten years.

In October 2015, the Company entered into a \$4.7 million construction loan with a commercial bank for a new corporate headquarters building. When fully funded upon the finish of construction of the building, the note is payable over 20 years at \$31,988 per month including interest and has an adjustable interest rate of 5.25%. The rate adjusts to prime plus 1% in the 61st month, with a floor of 5.25%. The new debt matures in twenty years. The Company has drawn \$961,000 on the loan as of March 31, 2016.

In December 2014, the Company refinanced certain real estate debt amounting to \$2.1 million with new bank debt of \$2.0 million. The new debt is payable \$13,270 per month, including interest at 5.25% and matures in ten years.

In December 2014, the Company borrowed \$1.0 million from an individual. The note is collateralized by certain real estate, is payable \$13,215 per month, including interest at 10% and matures in ten years.

In December 2014, the Company borrowed \$2.0 million from a lender. The 12% note is collateralized by a certain subsidiary's stock and is payable interest only until it matures in three years.

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7. LONG-TERM DEBT - continued

On January 13, 2015 a Company subsidiary purchased Down in Texas Saloon gentlemen's club in an Austin, Texas suburb. As part of the transaction, another subsidiary also purchased the club's real estate. Total consideration of \$6.8 million consisted of \$3.5 million for the club business and \$3.3 million for its 3.5 acres of real estate. Payment was in the form of \$1 million in cash and \$1.4 million in seller financing at 6% annual interest, with the balance provided by commercial bank financing at a variable interest rate equal to the prime rate plus 2%, but in no event less than 6.5%.

8. COMMON STOCK

On March 31, 2016, a related party creditor converted \$750,000 of debt to 75,000 shares of the Company's common stock.

During the six months ended March 31, 2016, the Company purchased and retired 500,902 common treasury shares. The cost of these shares was \$4.7 million.

During the six months ended March 31, 2015, the Company purchased and retired 192,427 common treasury shares. The cost of these shares was \$1.9 million.

During the six months ended March 31, 2015, the Company converted debt principal and interest valued at \$1.8 million into 177,018 common shares.

During the six months ended March 31, 2015, the Company issued 200,000 shares of common stock for the acquisition of a controlling interest in Drink Robust, Inc.

9. EARNINGS PER SHARE (EPS)

The Company computes earnings per share in accordance with GAAP, which provides for the calculation of basic and diluted earnings per share. Basic earnings per share 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 stock warrants and options (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 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).

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
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9. EARNINGS PER SHARE (EPS) - continued

	FOR THE QUARTER ENDED MARCH 31,		FOR THE SIX MONTHS ENDED MARCH 31,	
	2016	2015	2016	2015
Basic earnings per share:				
Net income (loss) attributable to RCIHH's shareholders	\$ 5,505	\$ (2,841)	\$ 8,057	\$ 519
Average number of common shares outstanding	10,013	10,275	10,154	10,269
Basic earnings (loss) per share - net income attributable to RCIHH's shareholders	\$ 0.55	\$ (0.28)	\$ 0.79	\$ 0.05
Diluted earnings per share:				
Net income (loss) attributable to RCIHH's shareholders	\$ 5,505	\$ (2,841)	\$ 8,057	\$ 519
Adjustment to net earnings from assumed conversion of debentures (1)	50	-	100	-
Adjusted net income (loss) attributable to RCIHH's shareholders	\$ 5,555	\$ (2,841)	\$ 8,157	\$ 519
Average number of common shares outstanding:				
Common shares outstanding	10,013	10,275	10,154	10,269
Potential dilutive shares resulting from exercise of warrants and options (2)	-	-	-	4
Potential dilutive shares resulting from conversion of debentures (3)	202	-	202	-
Total average number of common shares outstanding used for dilution	10,215	10,275	10,356	10,273
Diluted earnings (loss) per share - net income attributable to RCIHH's shareholders	\$ 0.54	\$ (0.28)	\$ 0.79	\$ 0.05

(1) Represents interest expense on dilutive convertible debentures that would not occur if they were assumed converted.

(2) All outstanding warrants and options were considered for the EPS computation. Potential dilutive options and warrants of 121,180 and 242,400 for the six months ended March 31, 2016 and 2015, respectively, have been excluded from earnings per share due to being anti-dilutive.

(3) Convertible debentures (principal and accrued interest) outstanding at March 31, 2016 and 2015 totaling \$2.3 million and \$6.0 million, respectively, were convertible into common stock at a price of \$10.00 to \$12.50 per share in 2015 and \$10.25 to \$12.50 in 2016. No potential dilutive shares for each of the three and six month periods ended March 31, 2016 have been excluded from earnings per share due to being anti-dilutive. During the three and six month periods ended March 31, 2015, 524,194 shares have been excluded from earnings per share due to being anti-dilutive each period.

* EPS may not foot due to rounding.

10. ACQUISITIONS

Six Months Ended March 31, 2015

On October 30, 2014, a 51% owned subsidiary of the Company ("Robust") acquired certain assets and liabilities of Robust Energy LLC for \$200,000 in cash and 200,000 shares of its restricted common stock for a total purchase price of \$3.6 million. The Company has also agreed to issue 50,000 shares of RCIHH common stock each to the two principals of Robust Energy LLC if Robust has net income of at least \$1 million during the 2015 calendar year. The principals entered into a Lock-Up Agreement with the Company in connection with the issuance by the Company of its shares of common stock as explained above, which will provide that none of the shares will be sold for a period of one year after the date of issuance and, thereafter, neither principal will sell more than 1/6th of their respective shares per month that they receive in connection herewith. Robust is an energy drink distributor, targeting the on premises bar and mixer market.

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10. ACQUISITIONS - continued

Six Months Ended March 31, 2015

The following information summarizes the preliminary allocation of fair values assigned to the assets and liabilities at the purchase date.

(in thousands)	
Inventory and accounts receivable	\$ 500
Equipment, furniture and fixtures	356
Definite-lived intangibles	4,931
Goodwill	5,326
Accounts payable	(1,482)
Notes payable	(963)
Deferred tax liability	(1,725)
Noncontrolling interest	(3,393)
Net assets	<u>\$ 3,550</u>

In accordance with GAAP, the Company recorded a gain of approximately \$229,000 on the value of its earlier 15% (\$750,000) investment in this company.

Goodwill from this transaction is deductible for tax purposes.

On January 13, 2015 a Company subsidiary purchased Down in Texas Saloon gentlemen's club in an Austin, Texas suburb. As part of the transaction, another subsidiary also purchased the club's real estate. Total consideration of \$6.8 million consisted of \$3.5 million for the club business and \$3.3 million for its 3.5 acres of real estate. Payment was in the form of \$1 million in cash and \$1.4 million in seller financing at 6% annual interest, with the balance provided by commercial bank financing at a variable interest rate equal to the prime rate plus 2%, but in no event less than 6.5%.

The following information summarizes the allocation of fair values assigned to the assets at the purchase date.

(in thousands)	
Buildings and land	\$ 3,130
Furniture and fixtures	20
Inventory	4
SOB license	3,546
Noncompete	100
Net assets	<u>\$ 6,800</u>

11. INCOME TAXES

Income tax expense on continuing operations for the periods presented differs from the "expected" federal income tax expense computed by applying the U.S. federal statutory rate of 34% to earnings before income taxes for the three and six months ended March 31, as a result of the following:

	For the Three Months Ended March 31,		For the Six Months Ended March 31,	
	2016	2015	2016	2015
Computed expected tax expense (benefit)	\$ 1,899	\$ (1,487)	\$ 3,193	\$ 251
State income taxes	64	74	127	148
Permanent differences	80	148	90	182
Section 45B credit	(1,750)	-	(1,750)	-
Income tax expense (benefit)	<u>\$ 293</u>	<u>\$ (1,265)</u>	<u>\$ 1,660</u>	<u>\$ 581</u>

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
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11. INCOME TAXES - continued

Included in the Company's deferred tax liabilities at March 31, 2016 is approximately \$16.4 million representing the tax effect of indefinite lived intangible assets from club acquisitions which are not deductible for tax purposes. These deferred tax liabilities will remain in the Company's balance sheet until the related clubs are sold.

During the quarter ended March 31, 2016, the Company discovered that it had not claimed certain FICA tip credits for certain years and has recently applied for those credits. The total net amount of the credits received, including fiscal years 2012 through the estimated amount as of March 31, 2016, amounts to \$1.75 million and has been deducted from income tax expense in the quarter ended March 31, 2016.

12. COMMITMENTS AND CONTINGENCIES

Legal Matters

Texas Patron Tax

The Company has reached a settlement with the State of Texas over payment of the state's Patron Tax on adult club customers. To resolve the issue of taxes owed, the Company agreed to pay \$10.0 million in equal monthly installments of \$119,000, without interest, over the next 84 months for all but two nonsettled locations. Going forward, the Company agreed to remit the Patron Tax on a monthly basis, based on the current rate of \$5 per customer. For accounting purposes, the Company has discounted the \$10.0 million at an imputed interest rate of 9.6%, establishing a net present value for the settlement of \$7.2 million. This amount, less payments made, is included as long-term debt in the consolidated balance sheets. As a consequence, the Company has recorded an \$8.2 million pre-tax gain for the third quarter ending June 30, 2015, representing the difference between the \$7.2 million and the amount previously accrued for the tax. The balance of the debt was \$6.6 million at March 31, 2016 and is included in long-term debt in the accompanying consolidated balance sheet.

Legal Matters

New York Settlement

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. Trial was scheduled to begin April 27, 2015. 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 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 to be 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.

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.

In accordance with GAAP, the Company expensed \$11.1 million during the year ended September 30, 2015 as the final liability for its obligations under the settlement. Of this amount \$5.6 million was paid to entertainers and \$5.5 million has been or will be paid to the lawyers. As of March 31, 2016 the Company has a total amount of \$3.6 million accrued with \$1.8 million included in accrued liabilities and \$1.8 million included in other long-term liabilities on the Company's consolidated balance sheet.

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.

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12. COMMITMENTS AND CONTINGENCIES – continued

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 multiple civil lawsuits pending or threatened against the Company and its subsidiaries; and other potential lawsuits for incidents that occurred before October 25, 2013 could still be filed. 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; 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, the Company has obtained general liability coverage from another insurer, effective October 25, 2013, which will cover any claims arising from actions after that date.

General

The Company is involved in various suits and claims arising in the normal course of business. The ultimate outcome of these items will not have a material adverse effect on the Company’s consolidated statements of income or financial position.

In April 2015, the Company was 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.

Settlements of lawsuits for the six months ended March 31, 2016 and 2015 totaled \$0.6 million and \$10.6 million, respectively.

13. SEGMENT INFORMATION

The Company is engaged in adult nightclubs and Bombshells Restaurants and Bars. The Company has identified such 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. Total assets are those assets controlled by each reportable segment. The other category below includes our media, Robust and internet divisions.

RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES
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13. SEGMENT INFORMATION - continued

Below is the financial information related to the Company's segments:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
Business segment sales:				
Night clubs	\$ 29,062	\$ 29,916	\$ 57,514	\$ 59,030
Bombshells	4,629	4,448	9,008	8,982
Other	705	625	1,349	1,182
	<u>\$ 34,396</u>	<u>\$ 34,989</u>	<u>\$ 67,871</u>	<u>\$ 69,194</u>
Business segment operating income (loss):				
Night clubs	\$ 9,734	\$ (818)	\$ 18,195	\$ 6,836
Bombshells	643	457	1,245	882
Other	(799)	(724)	(1,504)	(1,189)
General corporate	(2,028)	(1,531)	(4,669)	(3,005)
	<u>\$ 7,550</u>	<u>\$ (2,616)</u>	<u>\$ 13,267</u>	<u>\$ 3,524</u>
Business segment capital expenditures:				
Night clubs	\$ 12,435	\$ 710	\$ 12,505	\$ 675
Bombshells	104	676	144	1,553
Other	-	430	2	444
General Corporate	133	91	589	197
	<u>\$ 12,672</u>	<u>\$ 1,907</u>	<u>\$ 13,561</u>	<u>\$ 2,869</u>
Business segment depreciation and amortization:				
Night clubs	\$ 1,286	\$ 1,224	\$ 2,562	\$ 2,479
Bombshells	232	221	462	274
Other	171	304	342	510
General corporate	137	137	277	268
	<u>\$ 1,826</u>	<u>\$ 1,886</u>	<u>\$ 3,643</u>	<u>\$ 3,531</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

14. RESTRICTED STOCK ISSUANCE

In July 2014, the Company granted to an executive officer and an officer of a subsidiary an aggregate total of 96,325 shares of restricted stock. The total grant date fair value of all of these awards was \$938,478 and vest in two years. Restricted stock awards are awards of common stock that are subject to restrictions on transfer and to a risk of forfeiture if the awardee terminates employment with the Company prior to the lapse of the restrictions. The fair value of such stock was determined using the closing price on the grant date and compensation expense is recorded over the applicable vesting periods. Forfeitures are recognized as a reversal of expense of any unvested amounts in the period incurred. Unamortized expense amounted to \$120,012 at March 31, 2016. The compensation cost recognized for each of the six months ended March 31, 2016 and 2015 was \$240,024.

15. OTHER EXPENSES

Following is a breakout of the most significant items contained in other expenses in the consolidated statements of income:

(in thousands)	For the Three Months Ended March 31,		For the Six Months Ended March 31,	
	2016	2015	2016	2015
Security	\$480	\$481	\$1,018	\$921
Cleaning services and products	443	448	873	898
Maintenance and repairs	461	407	890	804
Other	1,939	1,581	3,722	3,167
Total other expenses	<u>\$ 3,323</u>	<u>\$ 2,917</u>	<u>\$ 6,503</u>	<u>\$ 5,790</u>

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 Form 10-K for the year ended September 30, 2015.

GENERAL

At the Company’s Annual Meeting of Stockholders on August 6, 2014, its name was officially changed from Rick’s Cabaret International, Inc. to RCI Hospitality Holdings, Inc. RCI Hospitality Holdings, Inc. (sometimes referred to as RCIHH herein) was incorporated in the State of Texas in 1994. Through our subsidiaries, as of April 30, 2016, we operate a total of forty-three establishments that offer live adult entertainment, and/or restaurant and bar operations. We have two reportable segments; nightclubs and Bombshells Restaurants and Bars. RCI Hospitality Holdings, Inc. is a holding company and operates through its subsidiaries including its management company, RCI Management Services, Inc. All services and management operations are conducted by subsidiaries of RCI Hospitality Holdings, Inc. In the context of club and bar/restaurant operations, the terms the “Company,” “we,” “our,” “us” and similar terms used in this Form 10-Q refer to subsidiaries of RCI Hospitality Holdings, Inc. Excepting executive officers of RCI Hospitality Holdings, Inc., any employment referenced in this document is not with RCI Hospitality Holdings, Inc. but solely with one of its subsidiaries.

SCHEDULE OF UNITS

Name of Establishment	Date Acquired/Opened
Club Onyx, Houston, TX	1995
Rick’s Cabaret, Minneapolis, MN	1998
XTC Cabaret, Austin, TX	1998
XTC Cabaret, San Antonio, TX	1998
XTC Cabaret, Houston, TX	2004
Rick’s Cabaret, New York City, NY	2005
Club Onyx, Charlotte, NC	2005
Rick’s Cabaret, San Antonio, TX	2006
XTC Cabaret, South Houston, TX	2006
Rick’s Cabaret, Fort Worth, TX	2007
Tootsie’s Cabaret, Miami Gardens, FL	2008
XTC Cabaret, Dallas, TX	2008
Club Onyx, Dallas, TX	2008
Club Onyx, Philadelphia, PA	2008
Rick’s Cabaret, Round Rock, TX	2009
Cabaret North, Fort Worth, TX	2009
Cabaret East, Fort Worth, TX	2010
Rick’s Cabaret DFW, Fort Worth, TX	2011
Downtown Cabaret, Minneapolis, MN	2011
Rick’s Cabaret, Indianapolis, IN	2011
Temptations, Aledo, TX	2011
Silver City Cabaret, Dallas, TX	2012
Jaguars Club, Odessa, TX	2012
Jaguars Club, Phoenix, AZ	2012
Jaguars Club, Lubbock, TX	2012
Jaguars Club, Longview, TX	2012
Jaguars Club, Tye, TX	2012
Jaguars Club, Edinburg, TX	2012
Jaguars Club, El Paso, TX	2012
Jaguars Club, Harlingen, TX	2012
Vee Lounge, Fort Worth, TX	2013
Bombshells, Dallas, TX	2013
Temptations, Sulphur, LA	2013
Temptations, Beaumont, TX	2013
Bombshells, Webster, TX	2013
The Black Orchid, Dallas, TX (Rebranded to Club Dulce in 2016)	2013
Vivid Cabaret, New York, NY	2014
Bombshells, Austin, TX	2014
Rick’s Cabaret, Odessa, TX	2014
Bombshells, Spring TX	2014
Bombshells, Houston, TX	2014
Down in Texas Saloon, Austin TX (Rebranded to Foxy’s Cabaret in 2016)	2015
The Seville, Minneapolis MN	2015

Our website address is www.rcihospitality.com. Upon written request, we make available free of charge our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with the SEC under the Securities Exchange Act of 1934, as amended. Information contained in the website shall not be construed as part of this Form 10-K.

CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles of the United States of America ("GAAP"). GAAP consists of a set of standards issued by the FASB and other authoritative bodies in the form of FASB Statements, Interpretations, FASB Staff Positions, Emerging Issues Task Force consensus and American Institute of Certified Public Accountants Statements of Position, among others. The Company has updated references to GAAP in this Form 10-Q to reflect the guidance in the ASC. The preparation of these 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.

Property and Equipment

Property and equipment are stated at cost. Provisions for depreciation and amortization are made using straight-line rates over the estimated useful lives of the related assets and the shorter of useful lives or terms of the applicable leases for leasehold improvements. Buildings have estimated useful lives ranging from 29 to 40 years. Furniture, equipment and leasehold improvements have estimated useful lives between five and 40 years. Expenditures for major renewals and betterments that extend the useful lives are capitalized. Expenditures for normal maintenance and repairs are expensed as incurred. The cost of assets sold or abandoned and the related accumulated depreciation are eliminated from the accounts and any gains or losses are charged or credited in the accompanying consolidated statement of income of the respective period.

Goodwill and Intangible Assets

GAAP addresses the accounting for goodwill and other intangible assets. Goodwill and intangible assets with indefinite lives are not amortized, but reviewed on an annual basis for impairment. Definite lived intangible assets are amortized on a straight-line basis over their estimated lives. Fully amortized assets are written-off against accumulated amortization.

Impairment of Long-Lived Assets

In accordance with GAAP, long-lived assets, such as property, plant, and equipment, and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired in accordance with GAAP. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. We did not perform the first or second step of the goodwill impairment test as of March 31, 2016 because we did not believe, after our evaluation of ASC 350-35-3C, that it was more likely than not that the fair value of any of our reporting units were less than their respective carrying amounts.

For goodwill, the impairment determination is made at the reporting unit level. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

Fair Value of Financial Instruments

The Company calculates the fair value of its assets and liabilities which qualify as financial instruments and includes this additional information in the notes to consolidated financial statements when the fair value is different than the carrying value of these financial instruments. The estimated fair value of accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to the relatively short maturity of these instruments. The carrying value of short and long-term debt also approximates fair value since these instruments bear market rates of interest. None of these instruments are held for trading purposes.

Revenue Recognition

The Company recognizes revenue from the sale of alcoholic beverages, energy drinks, food and merchandise, other revenues and services at the point-of-sale upon receipt of cash, check, or credit card charge.

Revenues from the sale of magazines and advertising content are recognized when the issue is published and shipped. Revenues and external expenses related to the Company's annual Expo convention are recognized upon the completion of the convention in August.

Income Taxes

Deferred income taxes are determined using the liability method in accordance with GAAP. 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. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In addition, a valuation allowance is established to reduce any deferred tax asset for which it is determined that it is more likely than not that some portion of the deferred tax asset will not be realized.

GAAP creates a single model to address accounting for uncertainty in tax positions by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. GAAP also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. There are no unrecognized tax benefits to disclose in the notes to the consolidated financial statements.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2016 AS COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2015

For the three months ended March 31, 2016, we had consolidated total revenues of \$34.4 million compared to consolidated total revenues of \$35.0 million for the three months ended March 31, 2015, a decrease of \$0.6 million or 1.7%. The decrease in total revenues was primarily attributable to a slight decrease in same-store sales. Total revenues for same-location-same-period of club operations decreased to \$32.9 million for the three months ended March 31, 2016 from \$33.2 million for the same period ended March 31, 2015.

Following is a comparison of the Company's income statement for the quarters ended March 31, 2016 and 2015 with percentages compared to total revenue:

(in thousands)	2016	%	2015	%
Sales of alcoholic beverages	\$ 14,581	42.4%	\$ 14,311	40.9%
Sales of food and merchandise	4,609	13.4%	4,837	13.8%
Service Revenues	13,205	38.4%	13,847	39.6%
Other	2,001	5.8%	1,994	5.7%
Total Revenues	34,396	100.0%	34,989	100.0%
Cost of Goods Sold	5,227	15.2%	5,381	15.4%
Salaries & Wages	7,917	23.0%	8,115	23.2%
Stock-based Compensation	120	0.3%	120	0.3%
Taxes and permits	3,274	9.5%	3,288	9.4%
Charge card fees	557	1.6%	544	1.6%
Rent	859	2.5%	1,184	3.4%
Legal & professional	982	2.9%	1,064	3.0%
Advertising and marketing	1,225	3.6%	1,312	3.7%
Insurance	907	2.6%	801	2.3%
Utilities	694	2.0%	708	2.0%
Depreciation and amortization	1,826	5.3%	1,886	5.4%
Gain on sale of property	(127)	-0.4%	(18)	-0.1%
Settlement of lawsuits and other one-time costs	62	0.2%	10,303	29.4%
Security	480	1.4%	481	1.4%
Cleaning services and products	443	1.3%	448	1.3%
Maintenance and repairs	461	1.3%	407	1.2%
Other	1,939	5.6%	1,581	4.5%
Total operating expenses	26,846	78.0%	37,605	107.5%
Operating income (loss)	7,550	22.0%	(2,616)	-7.5%
Interest income	1	0.0%	26	0.1%
Interest expense	(1,965)	-5.7%	(1,783)	-5.1%
Income (loss) from continuing operations before income taxes	\$ 5,586	16.2%	\$ (4,373)	-12.5%

Following is an explanation of significant variances in the above amounts.

Service revenues include cover charges, fees paid by entertainers, room rentals, memberships and fees charged for credit card processing. Other revenues include ATM commissions earned, video games and other vending, certain promotion fees charged to our entertainers and rents collected. We recognize revenue from other revenues and services at the point-of-sale upon receipt of cash, check, or credit card charge.

Cost of goods sold includes cost of alcoholic and non-alcoholic beverages, food, cigars and cigarettes, merchandise, media printing/binding and media postage. The cost of goods sold for the club and restaurant operations was 15.2% and 15.3% for the three months ended March 31, 2016 and 2015, respectively. The cost of goods sold for same-location-same-period of club and restaurant operations for the three months ended March 31, 2016 was 14.7%, compared to 14.6% for the same period ended March 31, 2015.

Payroll for same-location-same-period of club and restaurant operations was \$6.1 million for the three months ended March 31, 2016 and \$6.4 million for the same period in 2015. Management currently believes that its labor and management staff levels are appropriate.

The decrease in rent expense is due to the purchase of our Rick's New York and Tootsie's properties during the last few months. Our "cost of occupancy", calculated as rent plus interest, was 8.2% and 8.5% for the quarter ended 2016 and 2015, respectively.

The decrease in legal and professional expense is principally due to the labor lawsuit in New York which was active and settled in 2015.

See Note 12 of Notes to Consolidated Financial Statements for an explanation of the settlement of a lawsuit in 2015.

Income taxes (benefit), as a percentage of income (loss) before taxes was 5.2% and 28.9% for the quarters ended March 31, 2016 and 2015, respectively. The decrease in 2016 is principally due to the Company discovering that it had not claimed certain FICA tip credits for certain years and has recently applied for those credits. The total net amount of the credits received, including fiscal years 2012 through the estimated amount as of March 31, 2016, amounts to \$1.75 million and has been deducted from income tax expense in the quarter ended March 31, 2016.

Operating income (loss) (exclusive of corporate overhead) for same-location-same-period of club operations was \$9.3 million and \$(1.3) million for the quarters ended March 31, 2016 and 2015, respectively. The increase is due to the settlement of a lawsuit in 2015. Without the lawsuit settlement, operating income in the 2015 period would have been \$9.0 million.

Our “operating margin”, the percentage of operating income to total revenues, was 22.0% and (7.5)% for the quarters ended March 31, 2016 and 2015, respectively. Excluding the Settlement of lawsuits, the 2016 and 2015 operating margins would have been 22.1% and 22.0%, respectively.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED MARCH 31, 2016 AS COMPARED TO THE SIX MONTHS ENDED MARCH 31, 2015

For the six months ended March 31, 2016, we had consolidated total revenues of \$67.9 million compared to consolidated total revenues of \$69.2 million for the six months ended March 31, 2015, a decrease of \$1.3 million or 1.9%. The decrease in total revenues was primarily attributable to a slight decrease in same-store sales as a result in lower VIP spending.

Following is a comparison of the Company’s income statement for the six months ended March 31, 2016 and 2015 with percentages compared to total revenue:

(in thousands)	2016	%	2015	%
Sales of alcoholic beverages	\$ 29,178	43.0%	\$ 28,316	40.9%
Sales of food and merchandise	8,943	13.2%	9,670	14.0%
Service Revenues	25,846	38.1%	27,376	39.6%
Other	3,904	5.8%	3,832	5.5%
Total Revenues	67,871	100.0%	69,194	100.0%
Cost of Goods Sold	10,411	15.3%	10,492	15.2%
Salaries & Wages	16,052	23.7%	16,147	23.3%
Stock-based Compensation	240	0.4%	240	0.3%
Taxes and permits	6,501	9.6%	6,399	9.2%
Charge card fees	1,170	1.7%	1,091	1.6%
Rent	1,807	2.7%	2,325	3.4%
Legal & professional	2,087	3.1%	2,023	2.9%
Advertising and marketing	2,530	3.7%	2,679	3.9%
Insurance	1,781	2.6%	1,621	2.3%
Utilities	1,404	2.1%	1,442	2.1%
Depreciation and amortization	3,643	5.4%	3,531	5.1%
Gain on sale of property and marketable securities	(127)	-0.2%	(18)	0.0%
Impairment of assets	-	0.0%	1,358	2.0%
Settlement of lawsuits and other one-time costs	602	0.9%	10,550	15.2%
Security	1,018	1.5%	921	1.3%
Cleaning services and products	873	1.3%	898	1.3%
Maintenance and repairs	890	1.3%	804	1.2%
Other	3,722	5.5%	3,167	4.6%
Total operating expenses	54,604	80.5%	65,670	94.9%
Operating income	13,267	19.5%	3,524	5.1%
Interest income	3	0.0%	39	0.1%
Interest expense	(3,878)	-5.7%	(3,402)	-4.9%
Gain from acquisition of controlling interest in subsidiary	-	0.0%	577	0.8%
Income from continuing operations before income taxes	\$ 9,392	13.8%	\$ 738	1.1%

Following is an explanation of significant variances in the above amounts.

Service revenues include cover charges, fees paid by entertainers, room rentals, memberships and fees charged for credit card processing. Other revenues include ATM commissions earned, video games and other vending and certain promotion fees charged to our entertainers. We recognize revenue from other revenues and services at the point-of-sale upon receipt of cash, check, or credit card charge.

Cost of goods sold includes cost of alcoholic and non-alcoholic beverages, food, cigars and cigarettes, merchandise, media printing/binding, media postage and internet traffic purchases and webmaster payouts. The cost of goods sold for the club and restaurant operations for the six months ended March 31, 2016 was 15.0% compared to 14.7% for the six months ended March 31, 2015. The cost of goods sold for same-location-same-period of club and restaurant operations for the six months ended March 31, 2016 was 14.4%, compared to 14.2% for the same period ended March 31, 2015.

Payroll for same-location-same-period of club and restaurant operations was \$11.7 million for the six months ended March 31, 2016 and \$12.1 million for the same period in 2015. Management currently believes that its labor and management staff levels are appropriate.

The stock-based compensation for 2016 and 2015 represents amortization of restricted stock issued to certain employees.

The increase in legal and professional is due to an increase in legal fees associated with defending certain claims, less the fees associated with the labor lawsuit in New York which was active and settled in 2015.

During the quarter ended December 31, 2014, we recorded an impairment of \$1.4 million for the indefinite-lived intangible assets at our Temptations Cabaret in Lubbock.

The decrease in rent expense is due to the purchase of our Rick's New York and Tootsie's properties during the last few months. Our "cost of occupancy", calculated as rent plus interest was 8.4% and 8.3% for 2016 and 2015, respectively.

See Note 13 of Notes to Consolidated Financial Statements for an explanation of the settlement of a lawsuit in 2015.

Income taxes (benefit), as a percentage of income (loss) before taxes was 17.7% and 78.7% for the six months ended March 31, 2016 and 2015, respectively. The decrease in 2016 is principally due to the Company applying to claim certain additional IRC 45 B FICA credits for prior years. The total net amount received was \$1.75 million, covering the period from fiscal year 2012 through the estimated amount as of March 31, 2016. This amount was deducted from income tax expense in the quarter ended March 31, 2016.

Operating income (loss) (exclusive of corporate overhead) for same-location-same-period of club operations was \$19.9 million and \$10.7 million for the six months ended March 31, 2016 and 2015, respectively. The increase is due to the settlement of a lawsuit in 2015. Without the lawsuit settlement, operating income in the 2015 period would have been \$21.2 million.

See Note 10 of Notes to Consolidated Financial Statements for an explanation of the gain from original investment in Drink Robust, Inc.

SEGMENT INFORMATION

The Company is engaged in adult nightclubs and Bombshells Restaurants and Bars. The Company has identified such 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.

Below is the financial information related to the Company's segments:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
Business segment sales:				
Nightclubs	\$ 29,062	\$ 29,916	\$ 57,514	\$ 59,030
Bombshells	4,629	4,448	9,008	8,982
Other	705	625	1,349	1,182
	<u>\$ 34,396</u>	<u>\$ 34,989</u>	<u>\$ 67,871</u>	<u>\$ 69,194</u>
Business segment operating income:				
Nightclubs	\$ 9,734	\$ (818)	\$ 18,195	\$ 6,836
Bombshells	643	457	1,245	882
Other	(799)	(724)	(1,504)	(1,189)
General corporate	(2,028)	(1,531)	(4,669)	(3,005)
	<u>\$ 7,550</u>	<u>\$ (2,616)</u>	<u>\$ 13,267</u>	<u>\$ 3,524</u>
Business segment capital expenditures:				
Nightclubs	\$ 12,435	\$ 710	\$ 12,505	\$ 675
Bombshells	104	676	144	1,553
Other	-	430	2	444
General Corporate	133	91	589	197
	<u>\$ 12,672</u>	<u>\$ 1,907</u>	<u>\$ 13,561</u>	<u>\$ 2,869</u>
Business segment depreciation and amortization:				
Nightclubs	\$ 1,286	\$ 1,224	\$ 2,562	\$ 2,479
Bombshells	232	221	462	274

Other	171	304	342	510
General corporate	137	137	277	268
	<u>\$ 1,826</u>	<u>\$ 1,886</u>	<u>\$ 3,643</u>	<u>\$ 3,531</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

Nightclubs operating income above is reduced by \$10.3 million settlement of lawsuits and one-time costs for the three and six months ended March 31, 2015.

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 some non-recurring charges that 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, gain on settlement of patron tax case, pre-opening costs, gains and losses from asset sales, gain on settlement of patron tax issue, impairment of assets, pre-opening costs, stock-based compensation charges, litigation and other one-time legal settlements and acquisition costs. 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. While we were in litigation in the patron tax case, we also included patron taxes as an exclusion, but after settlement of the case, we no longer exclude patron taxes from operating income.

Non-GAAP Net Income and Non-GAAP Net Income per Basic Share and per Diluted Share . We exclude from non-GAAP net income and non-GAAP net income per diluted share and per basic share amortization of intangibles, gain on settlement of patron tax case, pre-opening costs, income tax expense, impairment charges, gains and losses from asset sales, stock-based compensation, litigation and other one-time legal settlements, gain on contractual debt reduction and acquisition costs, and include the Non-GAAP provision for income taxes, calculated as the tax-effect at 35% effective tax rate of the pre-tax non-GAAP income before taxes less stock-based compensation, because we believe that excluding such measures helps management and investors better understand our operating activities. While we were in litigation in the patron tax case, we also included patron taxes as an exclusion, but after settlement of the case, we no longer exclude patron taxes from net income.

Adjusted EBITDA . We exclude from Adjusted EBITDA depreciation expense, amortization of intangibles, income tax, interest expense, interest income, gains and losses from asset sales, pre-opening costs, acquisition costs, litigation and other one-time legal settlements, gain on settlement of patron tax case, gain on contractual debt reduction and impairment charges 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. Also, we exclude interest cost in our calculation of Adjusted EBITDA. 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.

The following tables present our non-GAAP measures for the periods ended March 31, 2016 and 2015 (in thousands, except per share amounts):

(in thousands)	For the Three Months Ended March 31,		For the Six Months Ended March 31,	
	2016	2015	2016	2015
Reconciliation of GAAP net income to Adjusted EBITDA				
GAAP net income (loss)	\$ 5,505	\$ (2,841)	\$ 8,057	\$ 519
Income tax expense	293	(1,265)	1,660	581
Interest expense and income and gain on Drink Robust investment	1,964	1,757	3,875	2,786
Litigation and other one-time legal settlements	62	10,303	602	10,550
Preopening costs	-	268	-	328
Acquisition costs	-	95	-	178
Impairment of assets	-	-	-	1,358
Depreciation and amortization	1,826	1,886	3,643	3,531
Adjusted EBITDA	<u>\$ 9,650</u>	<u>\$ 10,203</u>	<u>\$ 17,837</u>	<u>\$ 19,831</u>
Reconciliation of GAAP net income (loss) to non-GAAP net income				
GAAP net income (loss)	\$ 5,505	\$ (2,841)	\$ 8,057	\$ 519
Amortization of intangibles	197	336	399	579
Gain on Drink Robust investment	-	-	-	(577)
Stock-based compensation	120	120	240	240
Litigation and other one-time settlements	62	10,303	602	10,550
Pre-opening costs	-	268	-	328
Income tax expense	293	(1,265)	1,660	581
Acquisition costs	-	95	-	178
Impairment of assets	-	-	-	1,358
Non-GAAP provision for income taxes	(2,120)	(2,414)	(3,751)	(4,731)
Non-GAAP net income	<u>\$ 4,057</u>	<u>\$ 4,602</u>	<u>\$ 7,207</u>	<u>\$ 9,025</u>
Reconciliation of GAAP diluted net income per share to non-GAAP diluted net income per share				
Fully diluted shares	<u>10,215</u>	<u>10,275</u>	<u>10,356</u>	<u>10,273</u>
GAAP net income (loss)	\$ 0.54	\$ (0.28)	\$ 0.78	\$ 0.05
Amortization of intangibles	0.02	0.03	0.04	0.06
Gain on Drink Robust investment	-	-	-	(0.06)
Stock-based compensation	0.01	0.01	0.02	0.02
Litigation and other one-time settlements	0.01	1.00	0.06	1.03
Pre-opening costs	-	0.03	-	0.03
Income tax expense	0.03	(0.12)	0.16	0.06
Acquisition costs	-	0.01	-	0.02
Impairment of assets	-	-	-	0.13
Non-GAAP provision for income taxes	(0.21)	(0.23)	(0.36)	(0.46)
Non-GAAP diluted net income per share	<u>\$ 0.40</u>	<u>\$ 0.44</u>	<u>\$ 0.70</u>	<u>\$ 0.88</u>
Reconciliation of GAAP operating income to non-GAAP operating income				
GAAP operating income (loss)	\$ 7,550	\$ (2,616)	\$ 13,267	\$ 3,524
Amortization of intangibles	197	336	399	579
Stock-based compensation	120	120	240	240
Impairment of assets	-	-	-	1,358
Litigation and other one-time settlements	62	10,303	602	10,550
Pre-opening costs	-	268	-	328
Acquisition costs	-	95	-	178
Non-GAAP operating income	<u>\$ 7,929</u>	<u>\$ 8,506</u>	<u>\$ 14,508</u>	<u>\$ 16,757</u>
Reconciliation of GAAP operating margin to non-GAAP operating margin				
GAAP operating income	22.0%	-7.5%	19.5%	5.1%
Amortization of intangibles	0.6%	1.0%	0.6%	0.8%
Stock-based compensation	0.3%	0.3%	0.4%	0.3%

Impairment of assets	0.0%	0.0%	0.0%	2.0%
Litigation and other one-time settlements	0.2%	29.4%	0.9%	15.2%
Pre-opening costs	0.0%	0.8%	0.0%	0.5%
Acquisition costs	0.0%	0.3%	0.0%	0.3%
Non-GAAP operating margin	<u>23.1%</u>	<u>24.3%</u>	<u>21.4%</u>	<u>24.2%</u>

LIQUIDITY AND CAPITAL RESOURCES

We believe our ability to generate cash from operating activities is one of our fundamental financial strengths. Refer to the heading "Cash Flows from Operating Activities" below. The near-term outlook for our business remains strong, and we expect to generate substantial cash flows from operations in 2016. As a result of our expected cash flows from operations, we have significant flexibility to meet our financial commitments. We prefer not to raise capital through the issuance of common stock. Instead, we use debt financing, including convertible debt, to lower our overall cost of capital and increase our return on shareholders' equity. Refer to the heading "Cash Flows from Financing Activities" below. We have a history of borrowing funds in private transactions and from sellers in acquisition transactions and continue to have the ability to borrow funds at reasonable interest rates in that manner. We have historically utilized these cash flows to invest in property and equipment and adult nightclubs. Refer to the heading "Cash Flows from Investing Activities" below.

As of March 31, 2016, we had negative working capital of \$2.8 million compared to negative working capital of \$5.7 million as of September 30, 2015. Because of the large volume of cash we handle, stringent cash controls have been implemented. At March 31, 2016, our cash and cash equivalents were \$9.1 million compared to \$8.0 million at September 30, 2015.

Our depreciation for the six months ended March 31, 2016 was \$3.2 million compared to \$3.0 million for the six months ended March 31, 2015. Our amortization for the six months ended March 31, 2016 was \$399,000 compared to \$579,000 for the six months ended March 31, 2015.

Sources and Use of Funds

Cash flows from operating activities are generally the result of net income adjusted for depreciation and amortization expenses, deferred taxes, (increases) decreases in accounts receivable, inventories and prepaid expenses and increases (decreases) in accounts payable and accrued liabilities. See a summary of these activities below.

Cash flows used in investing activities generally reflect payments relating to acquisitions of businesses, property and equipment and marketable securities. See a summary of these activities below.

Cash flows from financing activities generally reflect proceeds from issuance of shares and long-term debt, and payments on debt and put options and purchase of treasury stock. See a summary of these activities below.

Cash Flows from Operating Activities

Following are our summarized cash flows from operating activities:

(In thousands)	Six Months Ended March 31,	
	2016	2015
Net income	\$ 7,732	\$ 157
Depreciation and amortization	3,643	3,531
Deferred taxes	786	1,461
Stock compensation expense	240	240
Deferred rents	(446)	(16)
Change in operating assets and liabilities	(731)	6,927
Impairment of assets	-	1,358
Gain from sale of assets and original investment in Drink Robust	(127)	(577)
Other	15	38
	<u>\$ 11,112</u>	<u>\$ 13,119</u>

Cash Flows from Investing Activities

(In thousands)	Six Months Ended March 31,	
	2016	2015
Additions to property and equipment	\$ (13,561)	\$ (2,869)
Proceeds from sale of marketable securities	628	-
Additions of businesses, net of cash acquired	-	(1,244)
	<u>\$ (12,933)</u>	<u>\$ (4,113)</u>

Following is a reconciliation of our additions to property and equipment for the six months ended March 31, 2016 and 2015:

(in thousands)	Six Months Ended March 31,	
	2016	2015
Acquisition of real estate	\$ 12,505	\$ 4,149
Capital expenditures funded by debt	-	(3,678)
New capital expenditure in new clubs	220	1,919
Maintenance capital expenditures	836	479
Total capital expenditures in consolidated statement of cash flows	<u>\$ 13,561</u>	<u>\$ 2,869</u>

Cash Flows from Financing Activities

(In thousands)	Six Months Ended March 31,	
	2016	2015
Proceeds from long-term debt	\$ 15,517	\$ 4,958
Payments on long-term debt	(7,553)	(8,234)
Payment of dividends	(296)	-
Purchase of treasury stock	(4,704)	(1,925)
Distribution of minority interests	(108)	(108)
	<u>\$ 2,856</u>	<u>\$ (5,309)</u>

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

(In thousands)	Six Months Ended March 31,	
	2016	2015
Operating activities	\$ 11,112	\$ 13,119
Investing activities	(12,933)	(4,113)
Financing activities	2,856	(5,309)
Net increase (decrease) in cash	<u>\$ 1,035</u>	<u>\$ 3,697</u>

We are not aware of any event or trend that would potentially affect our 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 six months ended March 31:

	2016	Increase (Decrease)	2015
Sales of alcoholic beverages	\$ 29,178	3.0%	\$ 28,316
Sales of food and merchandise	8,943	-7.5%	9,670
Service Revenues	25,846	-5.6%	27,376
Other	3,904	1.9%	3,832
Total Revenues	<u>\$ 67,871</u>	-1.9%	<u>\$ 69,194</u>
Net cash provided by operating activities	11,112	-15.3%	13,119
Adjusted EBITDA*	17,837	-9.1%	19,612
Long-term debt	101,713	42.2%	71,542

* See definition of adjusted EBITDA above under Results of Operations.

We have not established lines of credit or financing other than the above mentioned notes payable and our existing debt. 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.

Share repurchase

On September 29, 2008, our Board of Directors authorized us to repurchase up to \$5 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 million in stock authorized under this plan. On April 25, 2013, our Board of Directors authorized us to repurchase up to an additional \$3 million worth of our common stock. During May 2014, our Board of Directors increased the repurchase authorization to \$10 million. During the six months ended March 31, 2016, we purchased 500,902 shares of common stock in the open market and private transactions at prices ranging from \$8.00 to \$9.85 and under the plan, we have \$1.8 million remaining to purchase additional shares as of March 31, 2016.

Other Liquidity and Capital Resources

We have not established lines of credit or financing other than the notes payable and our existing debt. 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 with the strongest operating results occurring during October through March.

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 is: (a) to open new clubs after market analysis, (b) to acquire existing clubs in locations that are consistent with our growth and income targets and which appear receptive to the upscale club formula we have developed, (c) 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, (d) to develop new club concepts that are consistent with our management and marketing skills, (e) to develop and open our restaurant concepts as our capital and manpower allow, and/or (f) to control the real estate in connection with club operations, although some clubs may be in leased premises.

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 will require us to obtain additional debt or issuance of 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 March 31, 2016, 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, 2015.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of the Company's senior management, including the Company's chief executive officer and chief financial officer, the Company conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this quarterly report (the "Evaluation Date"). Based on this evaluation, the Company's chief executive officer and chief financial officer concluded as of the Evaluation Date that the Company's disclosure controls and procedures were effective such that the information relating to the Company, including consolidated subsidiaries, required to be disclosed in the Company's Securities and Exchange Commission ("SEC") reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including the Company's chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended March 31, 2016 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 "Legal Matters" under Note 12 of Notes to Consolidated Financial Statements above, which information is incorporated herein by reference.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended September 30, 2015, as such factors could materially affect the Company's business, financial condition or future results. In the three months ended March 31, 2016, there were no material changes to the risk factors disclosed in the Company's 2015 Annual Report on Form 10-K. 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 .

On September 29, 2008, our Board of Directors authorized us to repurchase up to \$5 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 million in stock authorized under this plan. On April 25, 2013, our Board of Directors authorized us to repurchase up to an additional \$3 million worth of our common stock. During May 2014, our Board of Directors increased the repurchase authorization to \$10 million. During the quarter ended March 31, 2016, we purchased 218,140 shares of common stock in the open market and private transactions at prices ranging from \$8.00 to \$9.85 and under the plan, we have \$1.8 million remaining to purchase additional shares as of March 31, 2016.

Following is a summary of our purchases by month during the quarter ended March 31, 2016:

(in thousands, except per share data)

Period:	(a)	(b)	(c)	(d)
Month Ending	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (2)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs(1)	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet be Purchased Under the Plans or Programs
Jan-16	61	\$ 8.67	61	\$ 3,229
Feb-16	62	\$ 8.28	62	\$ 2,714
Mar-16	95	\$ 9.14	95	\$ 1,848
Total for the three months ended March 31, 2016	218	8.76	218	\$ 1,848

(1) All shares were purchased pursuant to the repurchase plan approved in May 2014, as described above.

(2) Prices include any commissions and transaction costs.

Item 6. Exhibits.

Exhibit 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.

Exhibit 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.

Exhibit 32.1 — 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 Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.

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: May 10, 2016

By: /s/ Eric S. Langan

Eric S. Langan

Chief Executive Officer and President

Date: May 10, 2016

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, 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: May 10, 2016

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 March 31, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Chief Executive Officer and 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 their knowledge:

- (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
May 10, 2016

/s/ Phillip K. Marshall

Phillip K. Marshall
Chief Financial Officer
May 10, 2016

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.
