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**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 June 30, 2017

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

Commission File Number: 001-13992

**RCI HOSPITALITY HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

**Texas**  
(State or other jurisdiction of  
incorporation or organization)

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

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

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

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

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

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

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

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

As of July 31, 2017, 9,718,711 shares of the registrant's common stock were outstanding.

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## NOTE ABOUT FORWARD-LOOKING STATEMENTS

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

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

**RCI HOSPITALITY HOLDINGS, INC.**  
**FORM 10-Q**  
**TABLE OF CONTENTS**

|                |   |    |
|----------------|---|----|
| <b>PART I</b>  | <b><u>FINANCIAL INFORMATION</u></b>   |    |
| Item 1.        | <u>Financial Statements</u>   | 4  |
|                | <u>Condensed Consolidated Balance Sheets as of June 30, 2017 (unaudited) and September 30, 2016</u>                                     | 4  |
|                | <u>Condensed Consolidated Statements of Income (unaudited) for the three and nine months ended June 30, 2017 and 2016</u>               | 5  |
|                | <u>Condensed Consolidated Statements of Comprehensive Income (unaudited) for the three and nine months ended June 30, 2017 and 2016</u> | 6  |
|                | <u>Condensed Consolidated Statements of Cash Flows (unaudited) for the nine months ended June 30, 2017 and 2016</u>                     | 7  |
|                | <u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>   | 9  |
| Item 2.        | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>  | 22 |
| Item 3.        | <u>Quantitative and Qualitative Disclosures about Market Risk</u>   | 34 |
| Item 4.        | <u>Controls and Procedures</u>  | 34 |
| <b>PART II</b> | <b><u>OTHER INFORMATION</u></b>   |    |
| Item 1.        | <u>Legal Proceedings</u>  | 34 |
| Item 1A.       | <u>Risk Factors</u>   | 34 |
| Item 2.        | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 35 |
| Item 6.        | <u>Exhibits</u>   | 35 |
|                | <u>Signatures</u>   | 36 |

**PART I—FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

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

|  | <b>June 30, 2017</b> | <b>September 30, 2016</b> |
|--|----------------------|---------------------------|
|  | <b>(unaudited)</b>   |                           |
| <b>ASSETS</b>  |                      |                           |
| <b>Current assets</b>  |                      |                           |
| Cash and cash equivalents  | \$ 10,817            | \$ 11,327                 |
| Accounts receivables, net  | 2,312                | 4,365                     |
| Inventories  | 2,264                | 2,019                     |
| Prepaid expenses and other current assets  | 2,217                | 4,005                     |
| Assets held for sale   | 10,029               | 7,671                     |
| Total current assets   | 27,639               | 29,387                    |
| Property and equipment, net  | 145,581              | 141,268                   |
| Notes receivable   | 5,022                | 4,800                     |
| Goodwill   | 45,169               | 45,921                    |
| Intangibles, net   | 76,961               | 52,924                    |
| Other assets   | 2,294                | 2,188                     |
| Total assets   | \$ 302,666           | \$ 276,488                |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                      |                           |
| <b>Current liabilities</b>   |                      |                           |
| Accounts payable   | \$ 1,825             | \$ 1,701                  |
| Accrued liabilities  | 10,835               | 12,806                    |
| Current portion of long-term debt  | 16,237               | 9,950                     |
| Total current liabilities  | 28,897               | 24,457                    |
| Deferred tax liability   | 25,470               | 25,470                    |
| Long-term debt, net of loan costs and current portion  | 109,031              | 95,936                    |
| Other long-term liabilities  | 665                  | 483                       |
| Total liabilities  | 164,063              | 146,346                   |
| <b>Commitments and contingencies (Note 11)</b>   |                      |                           |
| <b>Stockholders' equity</b>  |                      |                           |
| Preferred stock, \$0.10 par value per share; 1,000 shares authorized; none issued and outstanding  | -                    | -                         |
| Common stock, \$0.01 par value per share; 20,000 shares authorized; 9,719 and 9,808 shares issued and outstanding as of June 30, 2017 and September 30, 2016, respectively | 97                   | 97                        |
| Additional paid-in capital   | 63,453               | 64,552                    |
| Retained earnings  | 72,530               | 62,909                    |
| Total RCIHH stockholders' equity   | 136,080              | 127,558                   |
| Noncontrolling interests   | 2,523                | 2,584                     |
| Total stockholders' equity   | 138,603              | 130,142                   |
| Total liabilities and stockholders' equity   | \$ 302,666           | \$ 276,488                |

See accompanying notes to condensed consolidated financial statements.

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

|   | For the Three Months<br>Ended June 30, |           | For the Nine Months<br>Ended June 30, |           |
|---|--|-----------|---------------------------------------|-----------|
|   | 2017                                   | 2016      | 2017                                  | 2016      |
| <b>Revenues</b>   |  |           |                                       |           |
| Sales of alcoholic beverages  | \$ 15,475                              | \$ 14,333 | \$ 44,085                             | \$ 43,511 |
| Sales of food and merchandise                                       | 4,641                                  | 4,614     | 13,201                                | 13,557    |
| Service revenues  | 15,350                                 | 12,780    | 42,995                                | 38,626    |
| Other   | 1,963                                  | 2,225     | 5,405                                 | 6,129     |
| Total revenues  | 37,429                                 | 33,952    | 105,686                               | 101,823   |
| <b>Operating expenses</b>   |  |           |                                       |           |
| Cost of goods sold  | 5,269                                  | 5,281     | 15,118                                | 15,692    |
| Salaries and wages  | 9,902                                  | 9,499     | 29,271                                | 28,113    |
| Selling, general and administrative                                 | 11,767                                 | 10,589    | 33,569                                | 32,050    |
| Depreciation and amortization                                       | 1,710                                  | 1,825     | 4,936                                 | 5,468     |
| Other charges, net  | 898                                    | 101       | 1,089                                 | 576       |
| Total operating expenses  | 29,546                                 | 27,295    | 83,983                                | 81,899    |
| Income from operations  | 7,883                                  | 6,657     | 21,703                                | 19,924    |
| <b>Other income (expenses)</b>                                      |  |           |                                       |           |
| Interest expense  | (2,205)                                | (2,040)   | (6,132)                               | (5,920)   |
| Interest income   | 61                                     | 1         | 187                                   | 6         |
| Income before income taxes  | 5,739                                  | 4,618     | 15,758                                | 14,010    |
| Income taxes  | 1,889                                  | 1,986     | 5,247                                 | 3,646     |
| Net income  | 3,850                                  | 2,632     | 10,511                                | 10,364    |
| Net loss (income) attributable to noncontrolling interests          | (9)                                    | 21        | (13)                                  | 346       |
| Net income attributable to RCIHH common shareholders                | \$ 3,841                               | \$ 2,653  | \$ 10,498                             | \$ 10,710 |
| <b>Earnings per share attributable to RCIHH common shareholders</b> |  |           |                                       |           |
| Basic   | \$ 0.40                                | \$ 0.27   | \$ 1.08                               | \$ 1.06   |
| Diluted   | \$ 0.40                                | \$ 0.27   | \$ 1.08                               | \$ 1.06   |
| <b>Weighted average number of common shares outstanding</b>         |  |           |                                       |           |
| Basic   | 9,719                                  | 9,906     | 9,735                                 | 10,071    |
| Diluted   | 9,719                                  | 10,047    | 9,751                                 | 10,211    |
| <b>Dividends per share</b>  | \$ 0.03                                | \$ 0.03   | \$ 0.09                               | \$ 0.06   |

See accompanying notes to condensed consolidated financial statements.

**RCI HOSPITALITY HOLDINGS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(in thousands)  
(unaudited)

|  | For the Three Months<br>Ended June 30, |                 | For the Nine Months<br>Ended June 30, |                  |
|--|--|-----------------|---------------------------------------|------------------|
|  | 2017                                   | 2016            | 2017                                  | 2016             |
| Net income   | \$ 3,850                               | \$ 2,632        | \$ 10,511                             | \$ 10,364        |
| Amounts reclassified from accumulated other comprehensive income     | -                                      | -               | -                                     | (109)            |
| Comprehensive income   | 3,850                                  | 2,632           | 10,511                                | 10,255           |
| Comprehensive loss (income) attributable to noncontrolling interests | (9)                                    | 21              | (13)                                  | 346              |
| Comprehensive income attributable to RCI Hospitality Holdings, Inc.  | <u>\$ 3,841</u>                        | <u>\$ 2,653</u> | <u>\$ 10,498</u>                      | <u>\$ 10,601</u> |

See accompanying notes to condensed consolidated financial statements.

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

|   | <b>For the Nine Months<br/>Ended June 30,</b> |                         |
|---|---|-------------------------|
|   | <b>2017</b>                                   | <b>2016</b>             |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |   |                         |
| Net income  | \$ 10,511                                     | \$ 10,364               |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |                         |
| Depreciation and amortization   | 4,936   | 5,468                   |
| Deferred taxes  | -   | 1,174                   |
| Impairment of assets  | 1,411   | -                       |
| Amortization of debt issuance costs, note discount and beneficial conversion      | 178   | 23                      |
| Deferred rent   | 182   | (427)                   |
| Gain on sale of marketable securities   | -   | (165)                   |
| Stock-based compensation expense  | -   | 360                     |
| Net gain on sale of property and other  | (838)   | -                       |
| Debt prepayment penalty   | 75  | -                       |
| Changes in operating assets and liabilities:                                      |   |                         |
| Accounts receivable   | 1,753   | 192                     |
| Inventories   | (134)   | (291)                   |
| Prepaid expenses and other assets   | 1,682   | 2,402                   |
| Accounts payable and accrued liabilities  | (1,859)                                       | (602)                   |
| Net cash provided by operating activities   | <u>17,897</u>                                 | <u>18,498</u>           |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |   |                         |
| Proceeds from sale of property  | 2,145   | -                       |
| Proceeds from sale of marketable securities                                       | -   | 628                     |
| Proceeds from notes receivable  | 78  | -                       |
| Additions to property and equipment   | (9,048)                                       | (17,576)                |
| Acquisition of businesses, net of cash acquired                                   | (9,527)                                       | -                       |
| Net cash used in investing activities   | <u>(16,352)</u>                               | <u>(16,948)</u>         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                       |   |                         |
| Proceeds from long-term debt  | 11,120  | 17,152                  |
| Payments on long-term debt  | (10,839)                                      | (9,726)                 |
| Purchase of treasury stock  | (1,099)                                       | (5,781)                 |
| Payment of dividends  | (877)   | (591)                   |
| Payment of loan origination costs   | (123)   | -                       |
| Debt prepayment penalty   | (75)  | -                       |
| Distribution to noncontrolling interests  | (162)   | (162)                   |
| Net cash provided by (used in) financing activities                               | <u>(2,055)</u>                                | <u>892</u>              |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                       | <u>(510)</u>                                  | <u>2,442</u>            |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>                           | <u>11,327</u>                                 | <u>8,020</u>            |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>                                 | <u><u>\$ 10,817</u></u>                       | <u><u>\$ 10,462</u></u> |
| <b>CASH PAID DURING PERIOD FOR:</b>   |   |                         |
| Interest  | \$ 5,778                                      | \$ 5,740                |
| Income taxes (net of refund of \$1,017 and \$0, respectively)                     | \$ 2,170                                      | \$ 289                  |

See accompanying notes to condensed consolidated financial statements.

Non-cash and other supplemental disclosures:

During the nine months ended June 30, 2017, the Company acquired a club location for a total consideration of \$26.0 million including \$20.6 million in seller financing, resulting in a cash payment of \$5.4 million at closing.

During the nine months ended June 30, 2017, the Company refinanced \$8.0 million of long-term debt by borrowing \$9.9 million, resulting in net cash proceeds of \$1.9 million.

During the nine months ended June 30, 2017, the Company sold a property for \$1.5 million in exchange for a \$1.5 million note payable reduction.

During the nine months ended June 30, 2017, the Company purchased and retired 89,685 common shares at a cost of \$1.1 million.

During the nine months ended June 30, 2016, the Company converted debt principal and interest valued at \$262,500 into 25,610 common shares.

During the nine months ended June 30, 2016, the Company purchased and retired 606,995 common shares at a cost of \$5.8 million.

During the nine months ended June 30, 2016, a related party creditor converted \$750,000 of debt to 75,000 shares of the Company's common stock.



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

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q of Regulation S-X. They do not include all information and footnotes required by GAAP for complete financial statements. 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, 2016 included in the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on December 13, 2016. The interim unaudited condensed consolidated financial statements should be read in conjunction with those consolidated financial statements included in the Form 10-K. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting solely of normal recurring adjustments, have been made. Operating results for the three and nine months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending September 30, 2017. The September 30, 2016 consolidated balance sheet data were derived from audited financial statements, but does not include all disclosures required by GAAP.

**2. Recent Accounting Standards and Pronouncements**

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

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 has adopted this guidance as of October 1, 2016, and its adoption had no impact on the Company's consolidated financial statements.

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 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 Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

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

In September 2015, the FASB issued ASU No. 2015-16, *Business Combinations (Topic 805): 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 Company has adopted this guidance as of October 1, 2016, and its adoption did not have a material impact on the Company's consolidated financial statements.

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

In March 2016, the FASB issued amended guidance ASU No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvement to Employee Share-Based Payment Accounting*. The guidance requires all income tax effects of awards to be recognized in the income statement on a prospective basis. The guidance also requires presentation of excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity, and can be applied retrospectively or prospectively. The guidance increases the amount companies can withhold to pay income taxes on awards without triggering liability classification for shares used to satisfy statutory income tax withholding obligations, and requires application of a modified retrospective transition method. The amended guidance will be effective for interim and annual periods beginning after December 15, 2016; early adoption is permitted if all provisions are adopted in the same period. As of June 30, 2017, we do not have any stock-based compensation awards outstanding. The Company has early adopted ASU 2016-09 as of October 1, 2016.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)*. The ASU intends to reduce diversity in practice on how the following cash activities are presented in the statement of cash flows: (1) debt prepayment or debt extinguishment costs; (2) settlement of zero-coupon debt instruments; (3) contingent considerations payments made after a business combination; (4) proceeds from the settlement of insurance claims; (5) proceeds from the settlement of corporate and bank-owned life insurance policies; (6) distributions received from equity method investments; and (7) beneficial interests in securitization transactions. The guidance also describes a predominance principle in which cash flows with aspects of more than one class that cannot be separated should be classified based on the activity that is likely to be the predominant source or use of cash flow. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted, provided that all of the amendments are adopted in the same period, and must be applied using a retrospective transition method. We early adopted this guidance as of October 1, 2016 in relation to debt prepayment penalty. There were no prior period transactions that need to be adjusted.

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

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

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. The amount of goodwill impairment will now be the excess of a reporting unit’s carrying value over its fair value, not to exceed the carrying amount of goodwill. All other goodwill impairment guidance will remain largely unchanged. Entities will continue to have the option to perform a qualitative assessment (Step 0) to determine if a quantitative impairment test is necessary. The same one-step test will be applied to goodwill at all reporting units, even those with zero or negative carrying amounts. Entities will be required to disclose the amount of goodwill at reporting units with zero or negative carrying amounts. The revised guidance will be applied prospectively, and is effective for calendar year-end SEC filers in 2020; other public business entities will have an additional year. Early adoption is permitted for any impairment tests performed after January 1, 2017. The Company plans to early adopt this ASU during the fourth quarter of fiscal 2017.

In May 2017, the FASB issued ASU No. 2017-09, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting*. The amendments of this ASU provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless all of the following are met: (1) the fair value of the modified award is the same as the fair value of the original award immediately before the modification; (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the modification; and (3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the modification. The current disclosure requirements in Topic 718 are not changed. The amendments in this ASU are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017, with early adoption permitted. As of June 30, 2017, we do not have any stock-based compensation awards outstanding. We will adopt ASU 2017-09 when the Company modifies any stock-based compensation awards in the future.

### **3. Reclassifications**

Certain prior year amounts have been reclassified to conform to the current year financial statement presentation.

### **4. Acquisitions and Dispositions**

#### Acquisitions

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

On April 26, 2017, subsidiaries of the Company acquired the assets of the Hollywood Showclub in the Greater St. Louis area, as well as the club's building and land, adjacent land, and a nearby building and land that can be used for another gentlemen's club. The total purchase price for all the acquired assets and real properties was \$4.2 million, paid in cash at closing.

The following information summarizes the allocation of fair values assigned to the assets at acquisition date (in thousands):

|                         |    |              |
|-------------------------|----|--------------|
| Land and building       | \$ | 3,200        |
| Furniture and equipment |    | 141          |
| Noncompete              |    | 200          |
| Other assets            |    | 77           |
| Goodwill                |    | 656          |
| Accrued liability       |    | (75)         |
| Net assets acquired     | \$ | <u>4,199</u> |

Management believes that the recorded goodwill represents the Company's expansion into the Greater St. Louis area. Goodwill will not be amortized, but will be tested at least annually for impairment. The goodwill balance of \$656,000, which was recognized in the Nightclubs segment, will be deductible for tax purposes.

On May 8, 2017, a subsidiary of the Company acquired the company that owns Scarlett's Cabaret Miami in Pembroke Park, Florida along with certain related intellectual property for total consideration of \$26.0 million, payable \$5.4 million at closing, \$5.0 million after six months through a short-term 5% note, and \$15.6 million through a 12-year amortizing 8% note. See Note 7.

The following information summarizes the allocation of fair values assigned to the assets at acquisition date (in thousands):

|                            |    |               |
|----------------------------|----|---------------|
| Furniture and equipment    | \$ | 633           |
| Leasehold improvement      |    | 1,222         |
| Definite-lived intangibles |    | 500           |
| SOB license                |    | 23,488        |
| Inventory                  |    | 109           |
| Net assets acquired        | \$ | <u>25,952</u> |

For the two preceding acquisitions, the Company has not finalized its valuation analysis and calculations in sufficient detail necessary to arrive at the fair value of assets acquired from the previous owners, along with the determination of any goodwill or gain on the transactions. Since the initial accounting has not been completed for the acquisitions, the Company has not yet allocated any amount to goodwill for the Scarlett's acquisition.

The Company's pro forma results of operations for the acquisitions have not been presented because the effect of the acquisitions was not material to our consolidated financial statements. Since the acquisition dates, the two acquisitions generated combined revenues of \$2.2 million that are included in the Company's consolidated statements of income for the three and nine months ended June 30, 2017.

#### Dispositions

On January 13, 2017, we closed the sale on one of our non-income producing properties, included in assets held for sale on our condensed consolidated balance sheet as of September 30, 2016, for \$2.2 million in cash, recognizing approximately \$116,000 loss on the sale. Proceeds were used to pay off the remaining \$1.5 million of a related 11% balloon note, which was due in 2018. The Company paid a \$75,000 prepayment penalty to pay off the debt.

On June 6, 2017, the Company closed on the sale of another non-income producing property, included in assets held for sale on the Company's condensed consolidated balance sheet as of September 30, 2016, for \$1.5 million, recognizing approximately \$0.9 million gain on the sale. The buyer owned one of the Company's note payable, hence, the Company exchanged the property for a \$1.5 million reduction in its note payable.

#### **5. Assets Held for Sale**

During the fourth quarter of fiscal 2016, the Company had decided to offer six real estate properties for sale. The aggregate estimated fair value of the properties less cost to sell as of September 30, 2016 was approximately \$7.7 million, which is primarily comprised of land and buildings, and reclassified to assets held for sale in the Company's consolidated balance sheet.

During the quarter ended March 31, 2017, the Company sold one of the properties held for sale for \$2.2 million, recognizing a \$116,000 loss. During the quarter ended June 30, 2017, the Company sold another property held for sale for \$1.5 million, recognizing a \$0.9 million gain. The gain or loss on the sale of these properties is included in other charges, net in our consolidated statements of income. See Note 4.

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

At the end of the quarter ended June 30, 2017, Company management decided to close an underperforming club in Dallas. The Company wrote off the balance of goodwill for that location and recorded an impairment charge amounting to \$1.4 million, which is included in other charges, net in our consolidated statements of income for the three and nine months ended June 30, 2017. The Company also recorded in assets held for sale the carrying value of the property for sale consisting principally of land and building amounting to \$5.2 million, which is lower than appraised value. The Company expects the property to be sold within 12 months.

The assets held for sale do not have liabilities associated with them that need to be directly settled from the proceeds in the event of a transaction.

**6. Selected Account Information**

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

|                                 | <b>June 30, 2017</b> | <b>September 30, 2016</b> |
|---------------------------------|----------------------|---------------------------|
| Payroll and related costs       | \$ 1,655             | \$ 1,506                  |
| Lawsuit settlement – legal fees | 1,871                | 2,704                     |
| Income taxes                    | 1,036                | -                         |
| Insurance                       | 447                  | 2,303                     |
| Sales and liquor taxes          | 910                  | 889                       |
| Patron tax                      | 808                  | 1,559                     |
| Unearned revenues               | 760                  | 256                       |
| Property taxes                  | 784                  | 1,017                     |
| Other                           | 2,564                | 2,572                     |
|                                 | <u>\$ 10,835</u>     | <u>\$ 12,806</u>          |

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

|                                  | <b>For the Three Months<br/>Ended June 30,</b> |                  | <b>For the Nine Months<br/>Ended June 30,</b> |                  |
|----------------------------------|--|------------------|---|------------------|
|                                  | <b>2017</b>                                    | <b>2016</b>      | <b>2017</b>                                   | <b>2016</b>      |
| Taxes and permits                | \$ 1,888                                       | \$ 1,943         | \$ 6,017                                      | \$ 6,122         |
| Advertising and marketing        | 1,708  | 1,407            | 4,720   | 3,937            |
| Supplies and services            | 1,245  | 1,218            | 3,533   | 3,635            |
| Insurance                        | 991  | 895              | 2,878   | 2,676            |
| Rent                             | 859  | 725              | 2,299   | 2,532            |
| Legal                            | 744  | 774              | 2,156   | 2,171            |
| Utilities                        | 695  | 692              | 2,021   | 2,096            |
| Charge card fees                 | 840  | 618              | 2,027   | 1,788            |
| Accounting and professional fees | 545  | 238              | 1,602   | 928              |
| Repairs and maintenance          | 546  | 523              | 1,545   | 1,546            |
| Security                         | 557  | 535              | 1,610   | 1,553            |
| Other                            | 1,149  | 1,021            | 3,161   | 3,066            |
|                                  | <u>\$ 11,767</u>                               | <u>\$ 10,589</u> | <u>\$ 33,569</u>                              | <u>\$ 32,050</u> |

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

**7. Long-Term Debt**

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

|  | June 30, 2017 | September 30, 2016 |
|--|---------------|--------------------|
| Notes payable at 10%-11%, mature August 2022 and December 2024   | \$ 2,437      | \$ 2,662           |
| Note payable at 7%, matures December 2019  | 105           | 133                |
| Notes payable at 5.5%, mature January 2023   | 1,178         | 1,238              |
| Notes payable at 5.5%, mature January 2023 and January 2022  | 4,601         | 4,864              |
| Note payable refinanced at 6.25%, matures July 2018  | 1,147         | 1,227              |
| Note payable at 6.3%, matures June 2030, collateralized by aircraft                                    | -             | 422                |
| Note payable at 9.5%, matures August 2024  | 9,017         | 10,642             |
| Notes payable at 9.5%, mature September 2024   | 5,083         | 7,040              |
| 6% convertible debentures, mature March 2023   | -             | 406                |
| Notes payable at 13%, mature October 2016 and 2017   | -             | 4,000              |
| Notes payable at 5%-7%, mature from 2018 to 2028   | 1,727         | 1,867              |
| Note payable at 11%, matures June 2018   | -             | 1,500              |
| 9% convertible debentures, mature October 2016   | -             | 452                |
| 7.45% note payable collateralized by aircraft, matures 2019  | 2,810         | 3,013              |
| Notes payable at 12%, mature December 2017 and September 2018  | -             | 4,000              |
| Non-interest-bearing debt to State of Texas, matures May 2022, interest imputed at 9.6%                | 5,488         | 6,201              |
| Note payable at 6.5%, matures January 2020   | 4,519         | 4,621              |
| Note payable at 6%, matures January 2019   | 595           | 857                |
| Notes payable at 5.5%, mature May 2020   | 5,364         | 5,493              |
| Note payable at 6%, matures May 2020   | 1,126         | 1,386              |
| Note payable at 5.3%, matures December 2024  | 1,792         | 1,842              |
| Note payable at 5.45%, matures July 2020   | 10,702        | 10,962             |
| Note payable at the greater of 2% above prime or 5% (5.5% at September 30, 2016), matures October 2025 | 4,334         | 4,430              |
| Note payable at 5%, matures January 2026   | 9,724         | 9,882              |
| Note payable at 5.25%, matures March 2037  | 4,684         | 4,442              |
| Note payable at 5%, matures July 2017  | -             | 2,157              |
| Note payable at 5%, matures February 2018  | 1,894         | 1,894              |
| Note payable at 5.95%, matures August 2021   | 8,438         | 8,945              |
| Note payable at 12%, matures October 2021  | 9,736         | -                  |
| Note payable at 9.58%, matures March 2022  | 366           | -                  |
| Note payable at 4.99%, matures April 2037, collateralized by aircraft                                  | 948           | -                  |
| Notes payable at 12%, mature June 2020   | 5,440         | -                  |
| Note payable at 5%, matures November 2017  | 5,000         | -                  |
| Note payable at 8%, matures May 2029   | 15,487        | -                  |
| Note payable at 5%, matures May 2037   | 2,163         | -                  |
| Total debt   | 125,905       | 106,578            |
| Less unamortized debt issuance costs   | (637)         | (692)              |
| Less current portion   | (16,237)      | (9,950)            |
| Total long-term debt, net  | \$ 109,031    | \$ 95,936          |

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

On October 5, 2016, the Company refinanced \$8.0 million of long-term debt by borrowing \$9.9 million. The new unsecured debt is payable \$118,817 per month, including interest at 12%, and matures in five years with a balloon payment for the remaining balance at maturity. The refinanced debt was comprised of interest-only notes that were scheduled to mature with full principal payments in October 2017.

On January 4, 2017, the Company paid off \$392,000 of convertible 6% notes, which would have matured on March 4, 2023.

On March 13, 2017, the Company entered into a promissory note with a bank, which provides for a \$1.0 million revolving line of credit maturing on March 13, 2018. The interest rate under this revolving line of credit is at 6.5% per annum payable every 13th of each month starting April 13, 2017 for all outstanding borrowings. In an event of a default, as defined in the agreement, the interest rate shall be increased to 17% per annum. As of June 30, 2017, the Company had available borrowing capacity of \$1.0 million under the revolving line of credit.

On May 1, 2017, the Company raised \$5.4 million through the issuance of 12% unsecured promissory notes to certain investors, which notes mature on May 1, 2020. The notes pay interest-only in equal monthly installments, with a lump sum principal payment at maturity. See Note 14.

On May 4, 2017, the Company entered into a construction loan agreement with a bank for the construction of the Company's Bombshells Pearland location. The maximum availability of the 5% promissory note is \$4.8 million with advances based on the progress of construction. On June 4, 2017, an initial advance of \$2.2 million was used to pay off a previous interest-only note for the same construction project. The new loan is payable interest-only until after one year from the date of the initial advance when the construction loan, including all advances as its principal, converts to an amortizing 20-year note with scheduled monthly payments to be determined on the date of conversion. The Company paid loan costs amounting to \$24,000, which will be amortized for the term of the note.

On May 8, 2017, in relation to the Scarlett's acquisition (see Note 4), the Company executed two promissory notes with the sellers: (i) a 5% short-term note for \$5.0 million payable in lump sum after six months from closing date and (ii) a 12-year amortizing 8% note for \$15.6 million. The 12-year note is payable \$168,343 per month, including interest.

As of June 30, 2017, the Company is in compliance with all its debt covenants.

Future maturities of long-term debt consist of the following (in thousands) as of June 30, 2017:

| <b>12-Month Period Ending</b> | <b>Regular<br/>Amortization</b> | <b>Balloon<br/>Payments</b> | <b>Total<br/>Payments</b> |
|-------------------------------|---------------------------------|-----------------------------|---------------------------|
| June 30, 2018                 | \$ 14,343                       | \$ 1,894                    | \$ 16,237                 |
| June 30, 2019                 | 7,817                           | 3,404                       | 11,221                    |
| June 30, 2020                 | 8,729                           | 15,238                      | 23,967                    |
| June 30, 2021                 | 8,626                           | 9,572                       | 18,198                    |
| June 30, 2022                 | 5,298                           | 22,226                      | 27,524                    |
| Thereafter                    | 21,759                          | 6,999                       | 28,758                    |
|                               | <u>\$ 66,572</u>                | <u>\$ 59,333</u>            | <u>\$ 125,905</u>         |

## 8. Stockholders' Equity

During the nine months ended June 30, 2017, the Company purchased and retired 89,685 common shares at a cost of \$1.1 million. The Company also paid a \$0.09 per share cash dividend totaling approximately \$877,000.

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

During the nine months ended June 30, 2016, the Company purchased and retired 606,995 common shares at a cost of \$5.8 million. The Company also paid a \$0.06 per share cash dividend totaling approximately \$591,000.

During the nine months ended June 30, 2016, the Company converted debt principal and interest valued at \$262,500 into 25,610 common shares.

During the nine months ended June 30, 2016, a related party creditor converted \$750,000 of debt to 75,000 shares of the Company's common stock.

**9. Earnings Per Share**

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

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

|   | <b>For the Three Months<br/>Ended June 30,</b> |             | <b>For the Nine Months<br/>Ended June 30,</b> |             |
|---|--|-------------|---|-------------|
|   | <b>2017</b>                                    | <b>2016</b> | <b>2017</b>                                   | <b>2016</b> |
| <b>Numerator -</b>  |  |             |   |             |
| Net income attributable to RCIHH common shareholders - basic            | \$ 3,841                                       | \$ 2,653    | \$ 10,498                                     | \$ 10,710   |
| Adjustment to net income from assumed conversion of debentures(2)       | -  | 33          | 5   | 100         |
| Adjusted net income attributable to RCIHH common shareholders - diluted | \$ 3,841                                       | \$ 2,686    | \$ 10,503                                     | \$ 10,810   |
| <b>Denominator(1)(3) -</b>  |  |             |   |             |
| Weighted average number of common shares outstanding - basic            | 9,719  | 9,906       | 9,735   | 10,071      |
| Effect of potentially dilutive restricted stock, warrants and options   | -  | 1           | -   | -           |
| Effect of potentially dilutive convertible debentures(2)                | -  | 140         | 16  | 140         |
| Adjusted weighted average number of common shares outstanding - diluted | 9,719  | 10,047      | 9,751   | 10,211      |
| Basic earnings per share  | \$ 0.40  | \$ 0.27     | \$ 1.08                                       | \$ 1.06     |
| Diluted earnings per share  | \$ 0.40  | \$ 0.27     | \$ 1.08                                       | \$ 1.06     |

(1) All outstanding restricted stock, warrants and options were considered for the EPS computation. Potentially dilutive options and warrants of 121,180 for the three and nine months ended June 30, 2016 have been excluded from earnings per share due to their being anti-dilutive. No restricted stock or options were outstanding during the three and nine months ended June 30, 2017.

(2) Convertible debentures (principal and accrued interest) outstanding at the beginning of the three months ended June 30, 2017 and 2016 totaling \$0 and \$1.6 million, respectively, and at the beginning of the nine months ended June 30, 2017 and 2016 totaling \$859,000 and \$3.8 million, respectively, were convertible into common stock at a price of \$10.25 and \$12.50 per share in fiscal 2017, and \$10.00, \$10.25 and \$12.50 per share in fiscal 2016. The last of the Company's convertible notes had been fully paid in March 2017.

(3) As of June 30, 2017, the Company has no outstanding restricted stock, stock options, warrants or convertible debt.



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

**10. Income Taxes**

Income tax expense was \$1.9 million and \$5.2 million for the three and nine months ended June 30, 2017, respectively, compared with \$2.0 million and \$3.6 million for the three and nine months ended June 30, 2016, respectively. The effective income tax rate for the nine months ended June 30, 2017 was 33.3% compared with 26.0% for the comparable period in the prior year. Our effective tax rate is affected by state taxes, permanent differences, and tax credits, including the FICA tax credit.

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

The Company accounts for uncertain tax positions pursuant to ASC Topic 740, *Income Taxes*. As of June 30, 2017 and September 30, 2016, the liability for uncertain tax positions totaled approximately \$437,000 and \$1.0 million, respectively, which is included in current liabilities on our condensed consolidated balance sheets, and is open to further evaluation. During the three and nine months ended June 30, 2017, the Company settled a city tax audit for approximately \$0 and \$0.6 million, respectively, the amount previously recorded as an uncertain tax position. This settlement did not have an impact on the annual effective tax rate. The Company recognizes interest accrued related to uncertain tax positions in interest expense and penalties in operating expenses.

**11. Commitments and Contingencies**

***Leases***

The Company leases certain equipment and facilities under operating leases, of which rent expense was approximately \$859,000 and \$725,000 for the three months ended June 30, 2017 and 2016, respectively, and approximately \$2.3 million and \$2.5 million for the nine months ended June 30, 2017 and 2016, respectively. Rent expense for the Company's operating leases, which generally have escalating rentals over the term of the lease, is recorded using the straight-line method over the initial lease term whereby an equal amount of rent expense is attributed to each period during the term of the lease, regardless of when actual payments are made. Generally, this results in rent expense in excess of cash payments during the early years of a lease and rent expense less than cash payments in the later years. The difference between rent expense recognized and actual rental payments is recorded as other long-term liabilities in the consolidated balance sheets.

In relation to the acquisition of Scarlett's in Pembroke Park, Florida (see Note 4), a subsidiary of the Company assumed the lease for the club building, and entered into a new lease for certain office space, a billboard and parking lot from an affiliate of the former owners. The remaining term of both leases expires in October 2035. Aggregate monthly rent of the leases amounts to \$78,000, subject to lease escalation.

***Legal Matters***

**New York Settlement**

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

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

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

The Company expensed \$11.1 million during the year ended September 30, 2015 as the final liability for its obligations under the settlement, which was included as settlement of lawsuits and other one-time costs in the consolidated statement of income. 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 June 30, 2017 and September 30, 2016, the Company has a total amount of \$1.9 million and \$2.7 million, respectively, recorded in accrued liabilities on the Company's consolidated balance sheets for future payments to the lawyers.

Indemnity Insurance Corporation

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

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

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

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

General

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

Settlements of lawsuits for the three and nine months ended June 30, 2017 totaled \$222,000 and \$303,000, respectively, while settlements of lawsuits for the three and nine months ended June 30, 2016 totaled \$139,000 and \$741,000, respectively. As of June 30, 2017 and September 30, 2016, the Company has accrued \$1.9 million and \$2.7 million in accrued liabilities, respectively, related to settlement of lawsuits all of which pertain to the New York Settlement discussed above.

From time to time, we are involved in or subject to legal, administrative and regulatory proceedings, claims, demands and investigations arising in the ordinary course of business, including direct claims brought by or against us with contracts, employment and other matters. We accrue for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgement is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. In addition, in the event we determine that a loss is not probable, but is reasonably possible, and it becomes possible to develop what we believe to be a reasonable range of possible loss, then we will include disclosure related to such a matter as appropriate and in compliance with ASC 450. The accruals or estimates, if any, are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular matter. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, we will, as applicable, adjust the accrual in the period the determination is made, disclose an estimate of the additional loss or range of loss, indicate that the estimate is immaterial to our financial statements as a whole, or, if the amount of such adjustment cannot be reasonably estimated, disclose that an estimate cannot be made.

**12. Segment Information**

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

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

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

|                                      | <b>For the Three Months</b> |                      | <b>For the Nine Months</b> |                   |
|--------------------------------------|-----------------------------|----------------------|----------------------------|-------------------|
|                                      | <b>Ended June 30,</b>       |                      | <b>Ended June 30,</b>      |                   |
|                                      | <b>2017</b>                 | <b>2016</b>          | <b>2017</b>                | <b>2016</b>       |
| <b>Revenues</b>                      |                             |                      |                            |                   |
| Nightclubs                           | \$ 32,575                   | \$ 28,336            | \$ 91,824                  | \$ 86,272         |
| Bombshells                           | 4,611                       | 5,005                | 13,281                     | 14,013            |
| Other                                | 243                         | 611                  | 581                        | 1,538             |
|                                      | <u>\$ 37,429</u>            | <u>\$ 33,952</u>     | <u>\$ 105,686</u>          | <u>\$ 101,823</u> |
| <b>Income (loss) from operations</b> |                             |                      |                            |                   |
| Nightclubs                           | \$ 10,579                   | \$ 9,172             | \$ 30,293                  | \$ 27,844         |
| Bombshells                           | 692                         | 905                  | 2,131                      | 2,150             |
| Other                                | (130)                       | (650)                | (693)                      | (2,154)           |
| General corporate                    | (3,258)                     | (2,770)              | (10,028)                   | (7,916)           |
|                                      | <u>\$ 7,883</u>             | <u>\$ 6,657</u>      | <u>\$ 21,703</u>           | <u>\$ 19,924</u>  |
| <b>Depreciation and amortization</b> |                             |                      |                            |                   |
| Nightclubs                           | \$ 1,344                    | \$ 1,274             | \$ 3,811                   | \$ 3,836          |
| Bombshells                           | 202                         | 237                  | 643                        | 700               |
| Other                                | 5                           | 171                  | 14                         | 513               |
| General corporate                    | 159                         | 143                  | 468                        | 419               |
|                                      | <u>\$ 1,710</u>             | <u>\$ 1,825</u>      | <u>\$ 4,936</u>            | <u>\$ 5,468</u>   |
| <b>Capital expenditures</b>          |                             |                      |                            |                   |
| Nightclubs                           | \$ 1,199                    | \$ 110               | \$ 3,618                   | \$ 12,616         |
| Bombshells                           | 1,164                       | 119                  | 3,882                      | 263               |
| Other                                | -                           | 4                    | 11                         | 6                 |
| General corporate                    | 1,005                       | 3,782                | 1,537                      | 4,691             |
|                                      | <u>\$ 3,368</u>             | <u>\$ 4,015</u>      | <u>\$ 9,048</u>            | <u>\$ 17,576</u>  |
|                                      |                             | <b>September 30,</b> |                            |                   |
|                                      | <b>June 30, 2017</b>        | <b>2016</b>          |                            |                   |
| <b>Total assets</b>                  |                             |                      |                            |                   |
| Nightclubs                           | \$ 275,252                  | \$ 244,464           |                            |                   |
| Bombshells                           | 10,940                      | 8,673                |                            |                   |
| Other                                | 1,113                       | 896                  |                            |                   |
| General corporate                    | 15,361                      | 22,455               |                            |                   |
|                                      | <u>\$ 302,666</u>           | <u>\$ 276,488</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.

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

**13. Noncontrolling Interests**

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

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

**14. Related Party Transaction**

On May 1, 2017, the Company raised \$5.4 million through the issuance of 12% unsecured promissory notes to certain investors ("Investors"), which notes mature on May 1, 2020. The notes pay interest-only in equal monthly installments, with a lump sum principal payment at maturity. See Note 7. The notes were issued to several creditors, which include a Company employee with a share of \$200,000. The terms of the employee note are uniform with all the other Investors' terms.

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

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

The following discussion should be read in conjunction with our consolidated financial statements and related notes thereto included in this quarterly report, and the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended September 30, 2016.

### ***Overview***

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

Through our subsidiaries, as of June 30, 2017, we operated a total of 44 establishments that offer live adult entertainment and/or restaurant and bar operations. We also operated a leading business communications company serving the multi-billion-dollar adult nightclubs industry. We have two principal reportable segments: Nightclubs and Bombshells. We combine other operating segments into “Other.” In the context of club and restaurant/sports bar operations, the terms the “Company,” “we,” “our,” “us” and similar terms used in this report refer to subsidiaries of RCIHH. Excepting executive officers of RCIHH, any employment referenced in this document is not with RCIHH but solely with one of its subsidiaries. RCIHH was incorporated in the State of Texas in 1994. Our corporate offices are located in Houston, Texas.

On April 26, 2017, subsidiaries of the Company acquired the assets of the Hollywood Showclub in the Greater St. Louis area, as well as the club’s building and land, adjacent land, and a nearby building and land that can be used for another gentlemen’s club. The total purchase price for all the acquired assets and real properties was \$4.2 million, paid in cash at closing.

On May 8, 2017, a subsidiary of the Company acquired the company that owns Scarlett’s Cabaret Miami in Pembroke Park, Florida along with certain related intellectual property for total consideration of \$26.0 million, payable \$5.4 million at closing, \$5.0 million after six months through a short-term 5% note, and \$15.6 million through a 12-year amortizing 8% note.

### ***Critical Accounting Policies and Estimates***

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

For a description of the accounting policies that, in management’s opinion, involve the most significant application of judgment or involve complex estimation and which could, if different judgment or estimates were made, materially affect our reported financial position, results of operations, or cash flows, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates” in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016 filed with the SEC on December 13, 2016.

During the three and nine months ended June 30, 2017, there were no significant changes in our accounting policies and estimates.

## Results of Operations

### Three Months Ended June 30, 2017 Compared to Three Months Ended June 30, 2016

The following table summarizes our results of operations for the three months ended June 30, 2017 and 2016 (dollars in thousands):

|                                     | For the Three Months Ended |               |               |               | Increase (Decrease) |        |
|-------------------------------------|----------------------------|---------------|---------------|---------------|---------------------|--------|
|                                     | June 30, 2017              |               | June 30, 2016 |               | Amount              | %      |
|                                     | Amount                     | % of Revenues | Amount        | % of Revenues |                     |        |
| <b>Revenues</b>                     |                            |               |               |               |                     |        |
| Sales of alcoholic beverages        | \$ 15,475                  | 41.3%         | \$ 14,333     | 42.2%         | \$ 1,142            | 8.0%   |
| Sales of food and merchandise       | 4,641                      | 12.4%         | 4,614         | 13.6%         | 27                  | 0.6%   |
| Service revenues                    | 15,350                     | 41.0%         | 12,780        | 37.6%         | 2,570               | 20.1%  |
| Other                               | 1,963                      | 5.2%          | 2,225         | 6.6%          | (262)               | -11.8% |
| Total revenues                      | 37,429                     | 100.0%        | 33,952        | 100.0%        | 3,477               | 10.2%  |
| <b>Operating expenses</b>           |                            |               |               |               |                     |        |
| Cost of goods sold                  | 5,269                      | 14.1%         | 5,281         | 15.6%         | (12)                | -0.2%  |
| Salaries and wages                  | 9,902                      | 26.5%         | 9,499         | 28.0%         | 403                 | 4.2%   |
| Selling, general and administrative | 11,767                     | 31.4%         | 10,589        | 31.2%         | 1,178               | 11.1%  |
| Depreciation and amortization       | 1,710                      | 4.6%          | 1,825         | 5.4%          | (115)               | -6.3%  |
| Other charges, net                  | 898                        | 2.4%          | 101           | 0.3%          | 797                 | *      |
| Total operating expenses            | 29,546                     | 78.9%         | 27,295        | 80.4%         | 2,251               | 8.2%   |
| Income from operations              | 7,883                      | 21.1%         | 6,657         | 19.6%         | 1,226               | 18.4%  |
| <b>Other income (expenses)</b>      |                            |               |               |               |                     |        |
| Interest expense                    | (2,205)                    | -5.9%         | (2,040)       | -6.0%         | (165)               | 8.1%   |
| Interest income                     | 61                         | 0.2%          | 1             | 0.0%          | 60                  | *      |
| Income before income taxes          | 5,739                      | 15.3%         | 4,618         | 13.6%         | 1,121               | 24.3%  |
| Income taxes                        | 1,889                      | 5.0%          | 1,986         | 5.8%          | (97)                | -4.9%  |
| Net income                          | \$ 3,850                   | 10.3%         | \$ 2,632      | 7.8%          | \$ 1,218            | 46.3%  |

\* Not meaningful.

## Revenues

Consolidated revenues for the three months ended June 30, 2017 increased by \$3.5 million, or 10.2%, compared to the comparable period last year due primarily to a 6.8% increase in same-store sales (contributing a 6.3% increase in total revenues), 10.3% increase from new units, 5.2% decrease in closed units, and 1.1% decrease in other revenues.

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

|            | For the Three Months Ended June 30, |                  |
|------------|-------------------------------------|------------------|
|            | 2017                                | 2016             |
| Nightclubs | \$ 32,575                           | \$ 28,336        |
| Bombshells | 4,611                               | 5,005            |
| Other      | 243                                 | 611              |
|            | <u>\$ 37,429</u>                    | <u>\$ 33,952</u> |

Nightclub revenues increased by \$4.2 million, or 15.0%, primarily due to \$3.5 million from new locations, \$2.1 million from comparable units, and partially offset by \$1.4 million from closed units. We had 40 clubs in the current quarter compared to 38 clubs during the comparable period last year.

Bombshells revenues decreased by \$397,000, or 7.9%, due to the closure of Webster in fiscal 2016.

Revenues for the quarter ended June 30, 2016 included revenues from Drink Robust of approximately \$404,000. During the quarter ended September 30, 2016, we sold 31% of Drink Robust, retaining a 20% investment, or \$1.2 million, which is included in other assets in the consolidated balance sheets. Because we have no ability to direct the management of the investee company or exert significant influence, the investment is being accounted for at cost beginning on the date of the sale.

### *Operating Expenses*

Total operating expenses, as a percent of revenues, decreased to 78.9% from 80.4% during the comparable quarter last year. Contributors to the net decrease in the percentage of operating expenses are explained below.

Cost of goods sold decreased by 0.2% despite the higher unit count. As a percent of total revenues, cost of goods sold decreased to 14.1% from 15.6% mainly due to the increase in revenue mix of higher margin service revenue.

Salaries and wages increased by 4.2% mainly due to additional corporate headcount to support franchising and our return to a growth model, and a shift to employee status of certain entertainers. As a percent of total revenues, salaries and wages decreased to 26.5% from 28.0% primarily due to leveraging of fixed corporate salaries on higher revenues.

Selling, general and administrative expenses increased by 11.1% primarily due to higher professional fees, increase in charge card fees in relation to higher revenues, and higher marketing expenses. As a percent of total revenues, selling, general and administrative expenses was flat at 31.4% this quarter compared to 31.2% in last year's third quarter.

Depreciation and amortization decreased by 6.3% due to the non-depreciation of assets held for sale.

Other charges, net increased by \$797,000 due to the \$1.4 million goodwill impairment of a unit that closed in July 2017, which is being marketed for sale, partially offset by a \$697,000 gain on disposal of assets.

### *Income from Operations*

For the three months ended June 30, 2017 and 2016, our operating margin was 21.1% and 19.6%, respectively. The main drivers for the increase in operating margin are the improvements in cost of goods sold and salaries and wages, partially offset by the goodwill impairment.

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

|                   | <b>For the Three Months<br/>Ended June 30,</b> |                 |
|-------------------|--|-----------------|
|                   | <b>2017</b>                                    | <b>2016</b>     |
| Nightclubs        | \$ 10,579                                      | \$ 9,172        |
| Bombshells        | 692  | 905             |
| Other             | (130)  | (650)           |
| General corporate | (3,258)  | (2,770)         |
|                   | <u>\$ 7,883</u>                                | <u>\$ 6,657</u> |

Operating margin for the Nightclubs segment was flat at 32.5% and 32.4% for the three months ended June 30, 2017 and 2016, respectively, while operating margin for Bombshells was 15.0% and 18.1%, respectively. The increase in Nightclubs operating margin includes the impact of the \$1.4 million goodwill impairment during the current quarter. The decrease in Bombshells operating margin was primarily caused by smaller same-store sales increase than the comparable quarter in the prior year, and training and pre-opening expenses of Bombshells 290, which opened in July 2017. Excluding the impact of the goodwill impairment, settlement of lawsuits, and gain on disposal of assets, Nightclubs non-GAAP operating margin would have been 35.3% and 33.9% for the three months ended June 30, 2017 and 2016, respectively. Bombshells did not have non-GAAP operating margin adjustments during the three months ended June 30, 2017 and 2016.



### Non-Operating Items

Interest expense increased to \$2.2 million from \$2.0 million due to higher average debt balance.

### Income Tax Expense

Income tax expense decreased by \$97,000 primarily due to lower state taxes partially offset by federal income taxes computed using the statutory rate. The effective income tax rate for the three months ended June 30, 2017 and 2016 was 32.9% and 43.0%, respectively, which was caused by lower states taxes, partially offset by lower FICA tax credit.

### Nine Months Ended June 30, 2017 Compared to Nine Months Ended June 30, 2016

The following table summarizes our results of operations for the nine months ended June 30, 2017 and 2016 (dollars in thousands):

|                                     | For the Nine Months Ended |               |               |               | Increase (Decrease) |        |
|-------------------------------------|---------------------------|---------------|---------------|---------------|---------------------|--------|
|                                     | June 30, 2017             |               | June 30, 2016 |               |                     |        |
|                                     | Amount                    | % of Revenues | Amount        | % of Revenues | Amount              | %      |
| Revenues                            |                           |               |               |               |                     |        |
| Sales of alcoholic beverages        | \$ 44,085                 | 41.7%         | \$ 43,511     | 42.7%         | \$ 574              | 1.3%   |
| Sales of food and merchandise       | 13,201                    | 12.5%         | 13,557        | 13.3%         | (356)               | -2.6%  |
| Service revenues                    | 42,995                    | 40.7%         | 38,626        | 37.9%         | 4,369               | 11.3%  |
| Other                               | 5,405                     | 5.1%          | 6,129         | 6.0%          | (724)               | -11.8% |
| Total revenues                      | 105,686                   | 100.0%        | 101,823       | 100.0%        | 3,863               | 3.8%   |
| Operating expenses                  |                           |               |               |               |                     |        |
| Cost of goods sold                  | 15,118                    | 14.3%         | 15,692        | 15.4%         | (574)               | -3.7%  |
| Salaries and wages                  | 29,271                    | 27.7%         | 28,113        | 27.6%         | 1,158               | 4.1%   |
| Selling, general and administrative | 33,569                    | 31.8%         | 32,050        | 31.5%         | 1,519               | 4.7%   |
| Depreciation and amortization       | 4,936                     | 4.7%          | 5,468         | 5.4%          | (532)               | -9.7%  |
| Other charges, net                  | 1,089                     | 1.0%          | 576           | 0.6%          | 513                 | *      |
| Total operating expenses            | 83,983                    | 79.5%         | 81,899        | 80.4%         | 2,084               | 2.5%   |
| Income from operations              | 21,703                    | 20.5%         | 19,924        | 19.6%         | 1,779               | 8.9%   |
| Other income (expenses)             |                           |               |               |               |                     |        |
| Interest expense                    | (6,132)                   | -5.8%         | (5,920)       | -5.8%         | (212)               | 3.6%   |
| Interest income                     | 187                       | 0.2%          | 6             | 0.0%          | 181                 | *      |
| Income before income taxes          | 15,758                    | 14.9%         | 14,010        | 13.8%         | 1,748               | 12.5%  |
| Income taxes                        | 5,247                     | 5.0%          | 3,646         | 3.6%          | 1,601               | 43.9%  |
| Net income                          | \$ 10,511                 | 9.9%          | \$ 10,364     | 10.2%         | \$ 147              | 1.4%   |

\* Not meaningful.

## Revenues

Consolidated revenues for the nine months ended June 30, 2017 increased by \$3.9 million, or 3.8%, compared to the comparable period last year due primarily to a 4.4% increase in same-store sales (contributing a 4.0% increase in total revenues), 4.6% increase from new units, 4.0% decrease in closed units, and 0.9% decrease in other revenues.

Segment contribution to total revenues for the nine-month period was as follows (in thousands):

|            | For the Nine Months<br>Ended June 30, |                   |
|------------|---------------------------------------|-------------------|
|            | 2017                                  | 2016              |
| Nightclubs | \$ 91,824                             | \$ 86,272         |
| Bombshells | 13,281                                | 14,013            |
| Other      | 581                                   | 1,538             |
|            | <u>\$ 105,686</u>                     | <u>\$ 101,823</u> |

Nightclub revenues increased by \$5.6 million, or 6.4%, primarily due to \$4.2 million from new locations, \$3.6 million from comparable units, and partially offset by \$2.3 million from closed units and other revenues combined.

Bombshells revenues decreased by \$735,000, or 5.2%, primarily due to the closure of Webster in fiscal 2016 partially offset by higher same-store sales.

Revenues for the nine months ended June 30, 2016 included revenues from Drink Robust of approximately \$884,000. During the quarter ended September 30, 2016, we sold 31% of Drink Robust, retaining a 20% investment, or \$1.2 million, which is included in other assets in the consolidated balance sheets. Because we have no ability to direct the management of the investee company or exert significant influence, the investment is being accounted for at cost beginning on the date of the sale.

## Operating Expenses

Total operating expenses, as a percent of revenues, decreased to 79.5% from 80.4% from year-ago. Contributors to the net decrease in the percentage of operating expenses are explained below.

Cost of goods sold decreased by 3.7% despite higher revenues for the year-to-date period. As a percent of total revenues, cost of goods sold decreased to 14.3% from 15.4% mainly due to the increase in revenue mix of higher margin service revenue.

Salaries and wages increased by 4.1% mainly due to additional corporate headcount to support franchising and our return to a growth model, and a shift to employee status of certain entertainers, offset partially by a decrease in stock-based compensation. As a percent of total revenues, salaries and wages was flat at 27.7% from 27.6% primarily due to additional corporate headcount to prepare for future growth and the shift to employee status of certain entertainers, partially offset by leveraging of fixed corporate salaries on higher revenues.

Selling, general and administrative expenses increased by 4.7% primarily due to increases in advertising and marketing, charge card fees and professional fees, partially offset by a decrease in rent expense. As a percent of total revenues, selling, general and administrative expenses increased to 31.8% from 31.5% mainly due to increases in advertising and marketing, charge card fees and professional fees, partially offset by decreases in rent expense and taxes and permits.

Depreciation and amortization decreased by 9.7% due to the non-depreciation of assets held for sale, decrease in intangible assets subject to amortization caused by the divestiture of Drink Robust and the lower fixed asset depreciable base from closed units.

Other charges, net increased by \$513,000 due to the \$1.4 million goodwill impairment of a unit that closed in July 2017, which is being marketed for sale, partially offset by lower lawsuit settlements and an increase in gain on disposal of assets.

### *Income from Operations*

For the nine months ended June 30, 2017 and 2016, our operating margin was 20.5% and 19.6%, respectively. The main drivers for the increase in operating margin are the improvements in cost of goods sold and salaries and wages, partially offset by the goodwill impairment.

Segment contribution to income from operations for the nine-month period is presented in the table below (in thousands):

|                   | <b>For the Nine Months<br/>Ended June 30,</b> |                  |
|-------------------|---|------------------|
|                   | <b>2017</b>                                   | <b>2016</b>      |
| Nightclubs        | \$ 30,293                                     | \$ 27,844        |
| Bombshells        | 2,131   | 2,150            |
| Other             | (693)   | (2,154)          |
| General corporate | (10,028)                                      | (7,916)          |
|                   | <u>\$ 21,703</u>                              | <u>\$ 19,924</u> |

Operating margin for the Nightclubs segment was 33.0% and 32.3% for the nine months ended June 30, 2017 and 2016, respectively, while operating margin for Bombshells was 16.0% and 15.3%, respectively. The increase in Nightclubs operating margin was mainly due to the increase in higher margin service revenue and margin improvement caused by sold and re-concepted clubs. The increase in Bombshells operating margin was primarily caused by the closing of the underperforming unit in Webster, Texas. Excluding the impact of the goodwill impairment, settlement of lawsuits, gain on settlement of patron tax, and gain on disposal of assets, Nightclubs non-GAAP operating margin would have been 34.1% and 33.1% for the nine months ended June 30, 2017 and 2016, respectively. Excluding the impact of loss on disposal of assets, Bombshells non-GAAP operating margin would have been 16.2% and 15.3% for the nine months ended June 30, 2017 and 2016, respectively.

### *Non-Operating Items*

Interest expense increased by \$212,000 due mainly from higher average debt balance and the debt prepayment penalty. Interest income increased by \$181,000 due to higher average cash balance and new notes receivable.

### *Income Tax Expense*

Income tax expense increased by \$1.6 million primarily due to lower FICA tax credit in the current year versus last year. The effective income tax rate for the nine months ended June 30, 2017 and 2016 was 33.3% and 26.0%, respectively, which was also mainly caused by the decrease in FICA tax credit, partially offset by lower state taxes.

## ***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 (or including) items that management believes are not representative of the ongoing business operations of the Company, but are included (or excluded) 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 impairment of assets, amortization of intangibles, gains or losses on sale of assets, stock-based compensation, gain on patron tax settlement, and settlement of lawsuits. We believe that excluding these items assists investors in evaluating period-over-period changes in our operating income and operating margin without the impact of items that are not a result of our day-to-day business and operations.

*Non-GAAP Net Income and Non-GAAP Net Income per Diluted Share .* We exclude from non-GAAP net income and non-GAAP net income per diluted share impairment of assets, amortization of intangibles, income tax expense, gains or losses on sale of assets, stock-based compensation, gain on patron tax settlement, and settlement of lawsuits, and include the non-GAAP provision for current and deferred income taxes, calculated as the tax effect at 33% and 35% year-to-date effective tax rate of the pre-tax non-GAAP income before taxes for the three and nine months ended June 30, 2017 and 2016, respectively, because we believe that excluding and including such items help management and investors better understand our operating activities.

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

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

The following tables present our non-GAAP performance measures for the three and nine months ended June 30, 2017 and 2016 (in thousands, except per share amounts and percentages):

|   | For the Three Months<br>Ended June 30, |                 | For the Nine Months<br>Ended June 30, |                  |
|---|--|-----------------|---------------------------------------|------------------|
|   | 2017                                   | 2016            | 2017                                  | 2016             |
| <b>Reconciliation of GAAP net income to Adjusted EBITDA</b>                                     |  |                 |                                       |                  |
| Net income attributable to RCIHH common shareholders  | \$ 3,841                               | \$ 2,653        | \$ 10,498                             | \$ 10,710        |
| Income tax expense  | 1,889                                  | 1,986           | 5,247                                 | 3,646            |
| Interest expense and income   | 2,144                                  | 2,039           | 5,945                                 | 5,914            |
| Settlement of lawsuits  | 222                                    | 139             | 303                                   | 741              |
| Gain on settlement of patron tax  | -                                      | -               | (102)                                 | -                |
| Impairment of assets  | 1,411                                  | -               | 1,411                                 | -                |
| Gain on sale of assets  | (735)                                  | (38)            | (523)                                 | (165)            |
| Depreciation and amortization   | 1,710                                  | 1,825           | 4,936                                 | 5,468            |
| Adjusted EBITDA   | <u>\$ 10,482</u>                       | <u>\$ 8,604</u> | <u>\$ 27,715</u>                      | <u>\$ 26,314</u> |
| <b>Reconciliation of GAAP net income to non-GAAP net income</b>                                 |  |                 |                                       |                  |
| Net income attributable to RCIHH common shareholders  | \$ 3,841                               | \$ 2,653        | \$ 10,498                             | \$ 10,710        |
| Amortization of intangibles   | 64                                     | 184             | 150                                   | 583              |
| Stock-based compensation  | -                                      | 120             | -                                     | 360              |
| Settlement of lawsuits  | 222                                    | 139             | 303                                   | 741              |
| Gain on settlement of patron tax  | -                                      | -               | (102)                                 | -                |
| Impairment of assets  | 1,411                                  | -               | 1,411                                 | -                |
| Income tax expense  | 1,889                                  | 1,986           | 5,247                                 | 3,646            |
| Gain on sale of assets  | (735)                                  | (38)            | (523)                                 | (165)            |
| Non-GAAP provision for income taxes   |  |                 |                                       |                  |
| Current   | (2,209)                                | (1,638)         | (5,605)                               | (3,649)          |
| Deferred  | -                                      | (99)            | -                                     | (1,839)          |
| Non-GAAP net income   | <u>\$ 4,483</u>                        | <u>\$ 3,307</u> | <u>\$ 11,379</u>                      | <u>\$ 10,387</u> |
| <b>Reconciliation of GAAP diluted earnings per share to non-GAAP diluted earnings per share</b> |  |                 |                                       |                  |
| Fully diluted shares  | 9,719                                  | 10,047          | 9,751                                 | 10,211           |
| Diluted EPS attributable to RCIHH common shareholders   | \$ 0.40                                | \$ 0.27         | \$ 1.08                               | \$ 1.06          |
| Amortization of intangibles   | 0.01                                   | 0.02            | 0.02                                  | 0.06             |
| Stock-based compensation  | -                                      | 0.01            | -                                     | 0.04             |
| Settlement of lawsuits  | 0.02                                   | 0.01            | 0.03                                  | 0.07             |
| Gain on settlement of patron tax  | -                                      | -               | (0.01)                                | -                |
| Impairment of assets  | 0.15                                   | -               | 0.14                                  | -                |
| Income tax expense  | 0.19                                   | 0.20            | 0.54                                  | 0.36             |
| Gain on sale of assets  | (0.08)                                 | (0.00)          | (0.05)                                | (0.02)           |
| Non-GAAP provision for income taxes   |  |                 |                                       |                  |
| Current   | (0.23)                                 | (0.16)          | (0.57)                                | (0.36)           |
| Deferred  | -                                      | (0.01)          | -                                     | (0.18)           |
| Non-GAAP diluted EPS  | <u>\$ 0.47</u>                         | <u>\$ 0.34</u>  | <u>\$ 1.17</u>                        | <u>\$ 1.03</u>   |
| <b>Reconciliation of GAAP operating income to non-GAAP operating income</b>                     |  |                 |                                       |                  |
| Income from operations  | \$ 7,883                               | \$ 6,657        | \$ 21,703                             | \$ 19,924        |
| Amortization of intangibles   | 64                                     | 184             | 150                                   | 583              |
| Stock-based compensation  | -                                      | 120             | -                                     | 360              |
| Settlement of lawsuits  | 222                                    | 139             | 303                                   | 741              |
| Gain on settlement of patron tax  | -                                      | -               | (102)                                 | -                |
| Impairment of assets  | 1,411                                  | -               | 1,411                                 | -                |
| Gain on sale of assets  | (735)                                  | (38)            | (523)                                 | (165)            |
| Non-GAAP operating income   | <u>\$ 8,845</u>                        | <u>\$ 7,062</u> | <u>\$ 22,942</u>                      | <u>\$ 21,443</u> |
| <b>Reconciliation of GAAP operating margin to non-GAAP operating margin</b>                     |  |                 |                                       |                  |
| GAAP operating income   | 21.1%                                  | 19.6%           | 20.5%                                 | 19.6%            |
| Amortization of intangibles   | 0.2%                                   | 0.5%            | 0.1%                                  | 0.6%             |
| Stock-based compensation  | 0.0%                                   | 0.4%            | 0.0%                                  | 0.4%             |

|                                  |       |       |       |       |
|----------------------------------|-------|-------|-------|-------|
| Settlement of lawsuits           | 0.6%  | 0.4%  | 0.3%  | 0.7%  |
| Gain on settlement of patron tax | 0.0%  | 0.0%  | -0.1% | 0.0%  |
| Impairment of assets             | 3.8%  | 0.0%  | 1.3%  | 0.0%  |
| Gain on sale of assets           | -2.0% | -0.1% | -0.5% | -0.2% |
| Non-GAAP operating margin        | 23.6% | 20.8% | 21.7% | 21.1% |

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

The adjustments to reconcile net income attributable to RCIHH common shareholders to non-GAAP net income exclude the impact of adjustments related to noncontrolling interests, which is immaterial. In the calculation of non-GAAP diluted net income per share, we take into consideration the adjustment to net income from the assumed conversion of debentures (see Note 9 to the condensed consolidated financial statements).

### ***Liquidity and Capital Resources***

At June 30, 2017, our cash and cash equivalents were \$10.8 million compared to \$11.3 million at September 30, 2016. Because of the large volume of cash we handle, we have very stringent cash controls. As of June 30, 2017, we had negative working capital of \$11.3 million compared to negative working capital of \$2.7 million as of September 30, 2016, excluding assets held for sale amounting to \$10.0 million and \$7.7 million, respectively. We believe our ability to generate cash from operating activities is one of our fundamental financial strengths. Our net cash provided by operating activities was \$17.9 million during the nine months ended June 30, 2017 compared to \$18.5 million during the nine months ended June 30, 2016. The near-term outlook for our business remains strong, and we expect to generate substantial cash flows from operations for the remainder of fiscal 2017. As a result of our expected cash flows from operations, we have significant flexibility to meet our financial commitments. Our operations have not required significant working capital and, like many companies in our industry, we have been able to operate, and will continue to operate, with negative working capital. Our requirement for working capital is not significant since our club and restaurant guests pay us in cash or payment cards at the time of sale. Thus, we are able to sell and collect payment for many of our inventory and services before we have to pay our suppliers. Our clubs and restaurants also do not require significant inventories and receivables.

We prefer to raise capital through the use of debt financing to lower our overall cost of capital and increase our return on shareholders' equity. 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 also have historically utilized cash flows from operations to invest in property and equipment and adult nightclubs.

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

|  | <b>For the Nine Months<br/>Ended June 30,</b> |             |
|--|---|-------------|
|  | <b>2017</b>                                   | <b>2016</b> |
| Operating activities                                 | \$ 17,897                                     | \$ 18,498   |
| Investing activities                                 | (16,352)                                      | (16,948)    |
| Financing activities                                 | (2,055)                                       | 892         |
| Net increase (decrease) in cash and cash equivalents | \$ (510)                                      | \$ 2,442    |

### **Cash Flows from Operating Activities**

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

|  | <b>For the Nine Months<br/>Ended June 30,</b> |             |
|--|---|-------------|
|  | <b>2017</b>                                   | <b>2016</b> |
| Net income                                 | \$ 10,511                                     | \$ 10,364   |
| Depreciation and amortization              | 4,936   | 5,468       |
| Deferred taxes                             | -   | 1,174       |
| Stock-based compensation expense           | -   | 360         |
| Impairment of assets                       | 1,411   | -           |
| Change in operating assets and liabilities | 1,442   | 1,701       |
| Other                                      | (403)   | (569)       |
| Net cash provided by operating activities  | \$ 17,897                                     | \$ 18,498   |

### **Cash Flows from Investing Activities**

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

|   | <b>For the Nine Months<br/>Ended June 30,</b> |             |
|---|---|-------------|
|   | <b>2017</b>                                   | <b>2016</b> |
| Additions to property and equipment             | \$ (9,048)                                    | \$ (17,576) |
| Acquisition of businesses, net of cash acquired | (9,527)                                       | -           |
| Proceeds from sale of property                  | 2,145   | -           |
| Proceeds from sale of marketable securities     | -   | 628         |
| Proceeds from notes receivable                  | 78  | -           |
| Net cash used in investing activities           | \$ (16,352)                                   | \$ (16,948) |

Following is a breakdown of our additions to property and equipment for the nine months ended June 30, 2017 and 2016 (in thousands):

|                                     | For the Nine Months<br>Ended June 30, |                  |
|-------------------------------------|---------------------------------------|------------------|
|                                     | 2017                                  | 2016             |
| Acquisition of real estate          | \$ -                                  | \$ 14,336        |
| New facilities capital expenditures | 7,743                                 | 1,452            |
| Maintenance capital expenditures    | 1,305                                 | 1,788            |
| Total capital expenditures          | <u>\$ 9,048</u>                       | <u>\$ 17,576</u> |

The capital expenditures during the nine months ended June 30, 2017 are composed primarily of construction and development costs for three new locations and our new corporate office, while the capital expenditures during the nine months ended June 30, 2016 are composed primarily of development costs of one new location and our new corporate office.

#### Cash Flows from Financing Activities

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

|   | For the Nine Months<br>Ended June 30, |               |
|---|---------------------------------------|---------------|
|   | 2017                                  | 2016          |
| Proceeds from long-term debt                        | \$ 11,120                             | \$ 17,152     |
| Payments on long-term debt                          | (10,839)                              | (9,726)       |
| Purchase of treasury stock                          | (1,099)                               | (5,781)       |
| Payment of loan origination costs                   | (123)                                 | -             |
| Payment of dividends                                | (877)                                 | (591)         |
| Debt prepayment penalty                             | (75)                                  | -             |
| Distribution to noncontrolling interests            | (162)                                 | (162)         |
| Net cash provided by (used in) financing activities | <u>\$ (2,055)</u>                     | <u>\$ 892</u> |

During the nine months ended June 30, 2017, we purchased and retired 89,685 shares of the Company's common stock at an average price of \$12.25 per share, while during the nine months ended June 30, 2016, we purchased and retired 606,995 shares of the Company's common stock at an average price of \$9.52 per share. We started paying \$0.03 per share quarterly dividend during the second quarter of fiscal 2016.

On October 5, 2016, the Company refinanced \$8.0 million of long-term debt by borrowing \$9.9 million. The new unsecured debt is payable \$118,817 per month, including interest at 12%, and matures in five years with a balloon payment for the remaining balance at maturity. The refinanced debt was comprised of interest-only notes that were scheduled to mature with full principal payments in October 2017.

On January 4, 2017, the Company paid off \$392,000 of convertible 6% notes, which would have matured on March 4, 2023.

On March 13, 2017, the Company entered into a promissory note with a bank, which provides for a \$1.0 million revolving line of credit maturing on March 13, 2018. The interest rate under this revolving line of credit is at 6.5% per annum payable every 13th of each month starting April 13, 2017 for all outstanding borrowings. In an event of a default, as defined in the agreement, the interest rate shall be increased to 17% per annum. As of June 30, 2017, the Company had available borrowing capacity of \$1.0 million under the revolving line of credit.

On May 1, 2017, the Company raised \$5.4 million through the issuance of 12% unsecured promissory notes to certain investors, which notes mature on May 1, 2020. The notes pay interest-only in equal monthly installments, with a lump sum principal payment at maturity.



On May 4, 2017, the Company entered into a construction loan agreement with a bank for the construction of the Company's Bombshells Pearland location. The maximum availability of the 5% promissory note is \$4.8 million with advances based on the progress of construction. On June 4, 2017, an initial advance of \$2.2 million was used to pay off a previous interest-only note for the same construction project. The new loan is payable interest-only until after one year from the date of the initial advance when the construction loan, including all advances as its principal, converts to an amortizing 20-year note with scheduled monthly payments to be determined on the date of conversion. The Company paid loan costs amounting to \$24,000, which will be amortized for the term of the note.

On May 8, 2017, in relation to the Scarlett's acquisition, the Company executed two promissory notes with the sellers: (i) a 5% short-term note for \$5.0 million payable in lump sum after six months from closing date and (ii) a 12-year amortizing 8% note for \$15.6 million. The 12-year note is payable \$168,343 per month, including interest.

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

|   | For the Nine Months<br>Ended June 30, |           |
|---|---------------------------------------|-----------|
|   | 2017                                  | 2016      |
| Net cash provided by operating activities | \$ 17,897                             | \$ 18,498 |
| Less: Maintenance capital expenditures    | 1,305                                 | 1,788     |
| Free cash flow                            | \$ 16,592                             | \$ 16,710 |

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 payables related to 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 nine months ended June 30:

|   | 2017       | Increase<br>(Decrease) | 2016       | Increase<br>(Decrease) | 2015      |
|---|------------|------------------------|------------|------------------------|-----------|
| Sales of alcoholic beverages              | \$ 44,085  | 1.3%                   | \$ 43,511  | 3.0%                   | \$ 42,225 |
| Sales of food and merchandise             | 13,201     | -2.6%                  | 13,557     | -5.5%                  | 14,341    |
| Service revenues                          | 42,995     | 11.3%                  | 38,626     | -4.7%                  | 40,538    |
| Other                                     | 5,405      | -11.8%                 | 6,129      | 10.3%                  | 5,556     |
| Total revenues                            | 105,686    | 3.8%                   | 101,823    | -0.8%                  | 102,660   |
| Net cash provided by operating activities | \$ 17,897  | -3.2%                  | \$ 18,498  | 1.2%                   | \$ 18,280 |
| Adjusted EBITDA*                          | \$ 27,715  | 5.3%                   | \$ 26,314  | -4.6%                  | \$ 27,590 |
| Long-term debt (at period end)            | \$ 125,268 | 24.1%                  | \$ 100,949 | 19.9%                  | \$ 84,173 |

\* See definition of Adjusted EBITDA above under Results of Operations.

### Share Repurchase

During the nine months ended June 30, 2017, we bought back 89,685 shares in the open market or through privately negotiated transactions at prices ranging from \$11.24 to \$13.87. During the nine months ended June 30, 2016, we bought back 606,995 shares in the open market or through privately negotiated transactions at prices ranging from \$8.00 to \$10.85. As of June 30, 2017, we have \$3.1 million authorized to purchase additional shares.

### Other Liquidity and Capital Resources

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 sexually oriented business industry is required in all states to convert dancers who are now independent contractors into employees.

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

### ***Impact of Inflation***

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

### ***Seasonality***

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

### ***Growth Strategy***

We believe that our nightclub operations can continue to grow organically and through careful entry into markets and demographic segments with high growth potential. Our growth strategy involves the following: (a) 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; (b) to open new clubs after market analysis; (c) to franchise our Bombshells brand; (d) 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; (e) to develop new club concepts that are consistent with our management and marketing skills; (f) to develop and open our restaurant concepts as our capital and manpower allow; and/or (g) to control the real estate in connection with club operations, although some clubs may be in leased premises.

In July 2017, we opened one Bombshells location in Houston, Texas. We currently have two Bombshells restaurants in development, with one expected to open in November 2017 and the other in March/April 2018. In the third quarter of fiscal 2017, we opened a second Studio 80 in Houston, Texas. We closed a re-concepted club in Dallas, and have listed the property for sale.

On April 26, 2017, subsidiaries of the Company acquired the assets of the Hollywood Showclub in the Greater St. Louis area, as well as the club's building and land, adjacent land, and a nearby building and land that can be used for another gentlemen's club. The total purchase price for all the acquired assets and real properties was \$4.2 million, paid in cash at closing. Also, on May 8, 2017, a subsidiary of the Company acquired the company that owns Scarlett's Cabaret Miami in Pembroke Park, Florida along with certain related intellectual property for total consideration of \$26.0 million, payable \$5.4 million at closing, \$5.0 million after six months through a short-term 5% note, and \$15.6 million through a 12-year amortizing 8% note.

We continue to evaluate opportunities to acquire new nightclubs and anticipate acquiring new locations that fit our business model as we have done in the past. The acquisition of additional clubs may require us to 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 June 30, 2017, there were no material changes to the information provided in Item 7A of the Company's Annual Report on Form 10-K for fiscal year ended September 30, 2016.

### **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 June 30, 2017. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in "*Internal Control—Integrated Framework (2013)*." Based on this evaluation, the Company's chief executive officer and chief financial officer concluded as of June 30, 2017 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 June 30, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II—OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

See the "Legal Matters" section within Note 11 of the condensed consolidated financial statements within this Quarterly Report on Form 10-Q, which information is incorporated herein by reference.

### **Item 1A. Risk Factors.**

There were no material changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2016. The risks described in the Annual Report on Form 10-K are not the only risks the Company faces. Additional risks and uncertainties not currently known to the Company, or that the Company deems to be immaterial, also may have a material adverse impact on the Company's business, financial condition or results of operations.

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

In September 2008, our Board of Directors authorized us to repurchase up to \$5.0 million worth of our common stock in the open market or in privately negotiated transactions. As of April 2013, we completed the repurchase of all \$5.0 million in stock authorized under this plan. In April 2013, our Board of Directors authorized us to repurchase up to an additional \$3.0 million worth of our common stock, and in May 2014, our Board of Directors increased the repurchase authorization by another \$7.0 million. In May 2016, the Board of Directors increased the repurchase authorization by an additional \$5.0 million. During the nine months ended June 30, 2017, we purchased 89,685 shares of common stock in the open market and private transactions at prices ranging from \$11.24 to \$13.87. As of June 30, 2017, we have \$3.1 million remaining to purchase additional shares.

We did not repurchase shares of the Company's common stock during the three months ended June 30, 2017.

## Item 6. Exhibits.

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

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

## SIGNATURES

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

### RCI HOSPITALITY HOLDINGS, INC.

Date: August 9, 2017

By: /s/ Eric S. Langan

Eric S. Langan  
Chief Executive Officer and President

Date: August 9, 2017

By: /s/ Phillip K. Marshall

Phillip K. Marshall  
Chief Financial Officer and Principal Accounting Officer



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

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

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

Date: August 9, 2017

By: /s/ Eric S. Langan

Eric S. Langan  
Chief Executive Officer and President

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**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: August 9, 2017

By: */s/ Phillip K. Marshall*

Phillip K. Marshall

Chief Financial Officer and Principal Accounting Officer

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**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 June 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, the Chief Executive Officer and the Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that based on our knowledge, that:

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

*/s/ Eric S. Langan*

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Eric S. Langan  
Chief Executive Officer  
August 9, 2017

*/s/ Phillip K. Marshall*

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Phillip K. Marshall  
Chief Financial Officer  
August 9, 2017

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.

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