Transcript of
RCI Hospitality Holdings, Inc.
1Q22 Earnings Call and Webcast
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Participants

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Gary Fishman - Investor Relations, RCI Hospitality Holdings, Inc.

Analysts

Joe Gomes - Noble Capital Markets
Anthony Lebiedzinski – Sidoti & Company
Adam Wyden - ADW Capital Management

Presentation

Operator
Greetings and welcome to RCI Hospitality Holdings' Conference Call and Webcast. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce Gary Fishman, who handles Investor Relations for RCI.

Gary Fishman - Investor Relations
Thank you, John. For those of you listening on the phone, you can find our presentation on the RCI website. Click Company and Investor Information under the RCI logo. That will take you to the Company and Investor Information page. Scroll down, and you'll find the necessary links.

Please turn to Page 2. I want to remind everybody of our Safe Harbor statement. It is posted at the beginning of our conference call presentation. It reminds you that you may hear or see forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those currently anticipated. We disclaim any obligation to update information disclosed in this call as a result of developments that occur afterward.

Please turn to Page 3. I also direct you to the explanation of non-GAAP measurements that we use. And I'd like to invite everyone listening in the New York City area to join us tonight at 6 o'clock to meet management at Rick's Cabaret in New York, Manhattan's number one gentlemen's club. You can also tour its sister club, Hoops Cabaret and Sports Bar, next door. Rick's is located at 50 West 33rd Street between Fifth Avenue and Broadway, around the corner from the Empire State Building. If you haven't RSVP-ed, ask for Eric Langan or me at the door.

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

Eric Langan - President and CEO
Thank you, Gary. Thank you for joining us today. I'm here with our CFO, Bradley Chhay.

After the market close, we reported our first quarter results. We want to thank our teams for delivering another strong quarter. Nightclubs and Bombshells continue to perform well. All 12 recent club acquisitions and our new company-owned Bombshells in Arlington, Texas also contributed to results for part of the quarter. We didn't experience any noticeable impact until December from the Omicron virus. To date, it has cycled quickly through our markets.

We are continuing to execute on all aspects of our growth plan for fiscal 2022. We expect to achieve further progress with our recent club acquisitions. Our first Bombshells franchisee should open in San Antonio this quarter or early in next quarter, and our AdmireMe website should do a soft launch during the same timeframe. We are actively pursuing new club acquisitions as well as Bombshells company-owned locations and new franchisees. Helping us to implement our capital allocation strategy is our recently announced bank loan.

Now here is Bradley to review the financials.

Bradley Chhay - CFO
Thanks, Eric. And good afternoon to all those listening. All of our comparisons in this call will be to the year ago first quarter, unless otherwise noted.

We generated total revenues of $61.8 million. That is up 61% year-over-year and up 28% compared to the pre-pandemic first quarter in fiscal 2020. GAAP EPS totaled $1.12 with non-GAAP EPS at $1.10. In the year ago quarter, we reported GAAP EPS of $1.07. That included a $4.9 million pre-tax gain equal to $0.55 per share from the debt extinguishment of our PPP loan. Excluding that and other standard items, non-GAAP EPS was $0.39 a year ago.

Net cash from operating activities was $16.3 million, an increase of 159%. Free cash flow totaled $15.3 million, which was up 169%. Net income increased 11.1% to $10.6 million. Now on a non-GAAP basis, net income was up 193% and adjusted EBITDA increased 107% to $18 million.

Please turn to Page 5. Nightclubs segment revenues, the operating margin, and income from operations were all up significantly from the year ago quarter. Revenues grew 86% year-over-year to $46.8 million. Operating margin was 40.1% compared to 33.7%, and the income from operations increased 121% to $18.7 million. This includes the benefit of our recent addition of 11 clubs since the acquisition in mid-October and another club acquired in early November. They contributed approximately 29% of the increase in revenues, and approximately 17% of the increase in operating income.

The segment also reflects strong performance from all of our other clubs, which were still heavily impacted by government-related COVID restrictions in the year ago quarter. Same-store sales were up 31% compared to the year ago quarter and up 8% compared to first quarter two years ago.

Revenues and operating margin also benefited from 107% year-over-year increase in high margin service revenue. This primarily reflected the success of our northern clubs as they continue to rebuild their VIP business.

As we've explained, the acquisitions are work-in progress. Our plan is to continue to improve staffing, service, revenues and margins as we move through the year.

Now if you would, please turn to Page 6. Bombshells had another solid quarter, with revenues of $14.8 million, operating margin of 19%, and income from operations of $2.8 million. This compares to the first quarter '21 revenues of $13 million, operating margin of 20.9%, and income from operations of $2.7 million.

The 14% increase in revenues reflects the benefit of our new Bombshells in Arlington, Texas. Since its opening to great success in early December, Arlington set a record for its first month in revenues for our new Bombshells and contributed approximately 45% of the revenue increase.

The quarter also reflects strong performance from our 10 other Bombshells. Same-store sales were up 8% compared to a year ago quarter and up 21% compared to the first quarter two years ago.

Operating margin and income were affected by more than two months of pre-opening costs without any sales for Arlington. Overall, we believe we've done a great job at managing the impact of food and labor inflation. As a result, operating margin stayed within the target range of 18% to 22%.

Going forward, operating margins should benefit from full quarters of Bombshells Arlington, without the effects of these pre-opening costs.

Now, please turn to Page 7 to review items in our first quarter consolidated statement of operations. Improvements in the margins of cost of goods sold, salaries and wages, and SG&A are all attributed to higher Nightclub revenues and margins during the quarter, as well as some of our continuing COVID era cost savings. As a result, GAAP operating margin was 25.7% compared to 17.1%. Interest expense also declined as a percentage of revenue although the dollar expense was slightly higher due to debt associated with the acquisition of the 12 clubs in October and November. Non-operating gains were significantly lower than a year ago quarter, which benefited from the debt forgiveness.

Please turn to Page 8. On December 30th, we acquired Scarlett's Cabaret Miami real estate for $7 million of cash. This left us with the cash balance of $18 million as of December 31st. With the $19 million bank loan that we closed in January, we ended the month of January with approximately $32 million in cash. Now, if we exclude the purchase of the Scarlett's property, we would have had a cash balance of approximately $39 million. The Scarlett's property was not part of the January bank loan. So, at some point, we will finance it and get a good portion of our cash out.

Free cash flow from our first quarter increased by 169% compared to a year ago. This was primarily due to a strong increase in net cash from operating activities, partially offset by a small increase in maintenance CapEx. Adjusted EBITDA increased 107%. Now as a percentage of revenue, free cash flow increased to 25% from 15% in the year ago quarter. Adjusted EBITDA increased to 29% from 23%.

Now if you would, please turn to Page 9 to review our debt and debt manageability. Debt, net of loan costs was $162 million as of December 31st, an increase of $37 million. This increase primarily reflected previously reported debt used to finance the October 2021 club acquisitions.

We continue to reduce our weighted average interest rate. Our first quarter rate was 6.26%, 51 basis points lower than a year ago. This was primarily due to the refinancing and pay down of higher rate debt. Our rate is almost 100 basis points down from five years ago. Our periodic refinancings, like the one we did in September, enables us to convert higher rate seller financing and other unsecured financing used in club acquisitions into lower rate commercial real estate bank debt.

Our refinancings also enables us to smooth out our debt maturity schedule. Now, as you can see, our amortization averages about $7 million a year for the next five years, which is very manageable with our cash flow.

Occupancy costs were 6.9% of revenues. This is well within our range of 6-9% that we've averaged when sales weren't dramatically impacted by COVID.

Please turn to Page 10 to look at our 12/31 debt pie chart. Our secured debt now consists of 62.5% of debt secured by real estate. This will be a little higher in the second quarter of 2022 as a result of the January refinancing. 21.6% listed as seller financing. This is secured by our respective clubs to which it applies. And lastly, 4.9% secured by other assets. Our unsecured debt consists of 10.8% of our debt, which is comparable to our 6/30/2021 balance sheet.

As I mentioned on our last call, we have reached the end of our SBA loan through forgiveness and are left with a small amount of repayment. We are nearing the end of our Texas Comptroller Settlement as well.

Now, let me turn the call back over to Eric. Thank you.

Eric Langan - President and CEO

Thanks, Bradley. Please turn to Slide 11. We're continuing to talk with new investors. This is a result of our meetings through the ICR and Sidoti conferences in January, and Noble Capital Markets' initiation of coverage. So I'd like to review our capital allocation strategy. Our goal is to drive shareholder value by increasing free cash flow per share 10% to 15% on a compounded annual basis.

Our strategy is similar to those outlined in the book, The Outsiders by William Thorndike. He studied companies that focused on generating cash per share and allocating that cash effectively to generate more cash. We have been applying those strategies since fiscal 2016 with three different actions, subject of course, to whether there is strategic rationale to do otherwise.

One is mergers and acquisitions, specifically buying the right clubs in the right markets. We like to buy good solid cash flowing clubs at 3-5 times adjusted EBITDA, using seller financing and acquire the real estate at market value. Another strategy is using cash to grow organically, specifically expanding Bombshells to develop critical mass, market awareness and sell franchises. Our goal in both M&A and organic growth is to generate annual cash on cash returns of at least 25% to 33%. The third action is buying back shares when the yield on our free cash flow per share is more than 10%.

Please turn to Slide 12. Regarding Nightclubs, we are making important progress with the clubs we acquired in the first quarter. As I mentioned on the last call, this is a COVID rebuilding effort. And as this materializes, we expect to see improving revenue and margin run rates. We anticipate reopening our rebuilt and rebranded club in Louisiana this quarter, and our remodeled and rebranded club in San Antonio next quarter.

Step-by-step, AdmireMe is coming to fruition. The mobile-friendly site is scheduled for a soft launch later this quarter or early next.

We are continuing to talk with club owners about acquiring their businesses. As part of our recent investor presentation, we said our current target is to buy clubs that can add about $20 million in adjusted EBITDA in fiscal 2023.

Regarding Bombshells, our new company-owned location in Arlington is doing very well. As Bradley mentioned, it set a record in December for the first month revenues for a new Bombshells. We are under contract to purchase land for two new Bombshells, one in Sapphire Bay in the Dallas market, and another in Stafford in the Houston market. We couldn't get a necessary specific use permit for another location in the Dallas area that we were looking at and so we're looking at other sites. We continue to talk to brokers in North, South, and West Florida, as well as the Phoenix market for more company-owned locations. Our first franchisee store should be open in San Antonio by the end of this quarter or the first part of next, and we continue to talk to other potential franchisees.

Regarding capital management, as Bradley mentioned, we acquired Scarlett's property for $7 million in cash. This is something we had planned to do. Our $18.7 million bank loan provides us with more resources to implement our capital allocation strategy, and we still have two excess properties under contract for sale.

This ends the formal presentation. A big thank you to all our teams—Nightclubs, Bombshells and corporate—for all your hard work and dedication. With that, we'll open the line for questions.

Operator
Thank you. Ladies and gentlemen, the floor is now open for questions. [Operator Instructions] And the first question is coming from Joe Gomes from Noble Capital. Your line is live.

Q: Excellent quarter guys. Just a quick question first here on the acquired Nightclubs. Doing the math real quick on the back of the envelope, that for the weeks that you had acquired them, they were generating a little over $6 million of revenue. Is that kind of where you were expecting, better or worse? Maybe just give us a little more color or a detail about how the integration of the acquired clubs is progressing.

<u>Eric Langan - President and CEO</u>
We knew it was going to be a challenge. They were short staffed. They weren't open full hours yet when we took over on October 18th. So we knew there's going to be some issues there. As we brought some people in from around the country from our other clubs, we were able to fill some spaces, get some stuff going, start building momentum. We did have an issue with some of the existing staff. We're very corporate and they were not used to that. So we had some turnover in existing staff as well. That compounded the problem. Then by late December, going into early January, we had COVID hit certain locations throughout the country. And so we've been dealing with that.

But as of now, I'm very excited about going forward. The numbers are getting better and better at the locations. Some of the locations are exceeding the 2019 numbers and some are still at about 60%. We'll continue to push and grow on those locations to get the right things in.

We had some remodeling CapEx done. So we're waiting, most of that is done now. We suspect that the majority, if not 100% of that, will be done by March 1st. There'll only be one major project left that we haven't started yet. And we're still working on approvals through the landlord. It's one of the rental properties but we want to change that property to a Rick's Cabaret and remodel and make it look more like our New York City store frontage in downtown Denver. Hopefully that will get done here as well in the next few months. It's right across the street from the Convention Center. So, it should be a really great look and definitely help increase that property's revenues and income.

But overall, we're very excited about the growth potential still at the existing clubs that we just purchased. I think that as far as our schedule has gone, we're on schedule. We think it could take from somewhere between March and May to get these locations back to 100-110%, which is where we want to see them at. Other than that, everything else has been great with those locations.

Q: Okay. Thanks for the color. And obviously, awesome contribution this quarter from the service revenues, partly, as you mentioned, the northern clubs getting back the VIP business. Do you think there's much more upside in that? Or is that kind of played out in terms of the people are back to the full extent, and we won't see that type of growth going forward?

<u>Eric Langan - President and CEO</u>
I think we're going to see more growth in that. You're going to see it return more to the mean. Service revenue used to be over 40% of our revenues. I think we're still down in the 20s right now. So I think there's considerable bandwidth there.

A lot of it could have to do with weather, as the weather gets nicer. I think March, April, May are going to be one of our strongest periods. I know March is part of the second quarter and April and May will be part of third quarter. But I still think those three months as a whole are going to be very, very strong for the company, and we're going to get a very good sense of what it is we're going to be looking like on a go-forward basis at some of our prime times.

I think that hopefully this last wave of COVID or Omicron will be kind of gone. Hopefully, there's nothing new that comes out. It seems to be weakening. So it should just ultimately go away, as they're saying, and that's going to give us a very, very strong—We've got a great sports lineup coming with March Madness coming up and some of the other events. Baseball, we start back up in April which should be great for us. Basketball season will be coming to a prime spot. I think it's a very exciting time for us during those three months, and hopefully the weather gets a little better. There was a big storm last week all across the Northeast, freezing down all the way into Texas, and some freezing rain and snow actually in the Dallas market, again. Last year, it hit us in the second and third week of February, which is our prime time. This time hitting our first week of February. I'm hoping that'll kind of flow past, and we'll get a nice 6-week run as we run into the last six weeks of this quarter—the last two weeks of February and then the four weeks in March. So maybe even a 7 week, nice 7-week run.

This quarter is still good. January was still a very solid [month] for us. I was thinking we would come in closer to $22 million. We were a little over $20 million in sales for January. That will be still better than we did in October. This quarter is still ahead of last quarter on a going forward run rate for the first quarter-second quarter. And we'll just have to see like how these next 9 weeks play out. Hopefully, very strong for us.

Q: Right, right. And speaking of sporting events, I know when you get a Super Bowl in a location, it can really have a nice up kick. I know the Formula One race is coming into Miami in April. Outside of that, are there any other big one-time events like that, that you see that will be coming this year towards where any your club locations are?

Eric Langan - President and CEO
I think there's some big Bitcoin and NFT conferences that are coming to some of our areas. We're in the process of accepting Bitcoin at some of our locations, which I think will help dramatically starting in Miami with the big Bitcoin conference coming up there in April. We're hoping to have that in place by then.

We're working on some other cool things like a helicopter landing pad at Tootsie's in Miami, because we've had several requests from some big VIPs. They want to land their helicopter at the club. We're like, well, we can work that out, I think. We're in the process of doing stuff like that. That location is just phenomenal right now, the numbers it is doing. We're still running record numbers. We never even dreamed pre-COVID that we could do the volume that club is doing now.

The race is going to be incredible for us, I think. It brings a lot of big money into the area. Formula One is very expensive. We know from Austin, where our clubs are still 60 miles to 70 miles from the track, and we still get business in Austin, Texas when Formula One is there. I'm not 100% sure of the location of the track, but I know it's just blocks, the track is literally blocks from Tootsie's there. So, it should be a really big draw for us as well.

Q: One more if I may and then I'll get back in queue. You were talking about a soft launch of the AdmireMe site in the second quarter, maybe early third quarter. What kind of metrics are you looking for in the soft launch?

Eric Langan - President and CEO
I want to get 1,000 creators on the site. That is our initial goal. To put 1,000 creators, new creators on the site, from our clubs and our partners' clubs. Combined, there's about 70 some clubs around the country that are going to be involved in the initial launch. Hopefully, we'll add other clubs as time goes on, through our acquisitions, through their expansion, and through maybe partnerships with other club owners as well, to continue to build the site.

But I think our first metric has to be hitting the goal of 1,000 creators. At 1,000 creators, I think that it has enough momentum on its own that we can just let it build on its own from there. Then we can convert to a more of a promotion mode, where we're really trying to bring in more customers and guests for those creators. And then, of course, we'll need more creators and then we'll need more customers and just the chicken and egg effect and just balance and build and balance and build. Try not to let either get ahead of the stuff, where we have too many customers and not enough creators or too many creators and not enough customers. I think that's the delicate balance for us. I think we'll have a really good handle on that, how that's looking, by the May call. That's my personal thoughts on that.

Q: Okay, great. Thanks for all that, Eric. Appreciate again. Great quarter. I'll let someone else ask some questions. Thank you.

Eric Langan - President and CEO
All right. Thank you.

Operator
[Operator Instructions] The next question is coming from Anthony Lebiedzinski from Sidoti. Anthony, your line is live.

Q: Thank you and good afternoon. And thank you for taking the questions. Certainly a very impressive start to the fiscal year even with some headwinds with Omicron. Eric, is there any way you can perhaps take a shot at estimating what the impact of Omicron was as far as sales for the quarter?

Eric Langan - President and CEO
For the quarter it's difficult, but I would say, it probably affected us around 10% in December, and January, probably about the same. I don't think we'll see any effect in February from it. I think it's kind of ran its course in our markets for the most part, at least our major markets. Texas is kind of done now.

It wiped out our corporate office. We were very skeleton staff getting this Q finished up, and we were actually a little worried about it at a couple of points. Like, are we going to be able to get all this work done? Because every other day somebody else was, I'm positive, I can't come in now.

Bradley did a great job of getting that all handled and taken care of and went through the COVID himself. So he knows. Luckily, it was very short. Most of them were sick but out for two to three weeks total and that's with all the precautionary hold times. They weren't really sick for more than about five days or so. But we did a 10-day hold. Most of this was before they changed it to a 5-day. We were making them 10 days, get negative tests, all that type of stuff before we let people back in our offices, because we couldn't afford to keep losing people. Especially the key people that were there. We had people coming in at night to avoid each other. Whatever we had to do to get this closed out and done for the quarter and get the Q out on time.

Q: Got you, okay. Well, I'm glad that everyone is healthy now. It sounds like in the corporate office and you guys were able to finish up the 10-Q and so on. Looking forward here, as far as the segment operating margin, obviously, Bombshells did take into account some of the preopening expenses for the new Arlington location. Is it safe to assume that sequentially you should see better operating margins there? And if you want to just comment on the Nightclubs as to how we should think about the segment op margin there?

Eric Langan - President and CEO
I think we're kind of maxing on the Nightclubs. But then again, I don't know. As service revenue continues to grow and Tootsie's is doing the numbers it's doing, as the Denver market really picks up for us as the guys are saying they expect it to for the month of March, we could see a little bit better there.

As far as the Bombshells, I think we're going to stay in the 18% to 22% and maybe occasionally we're going to have some big events that blow us up to that 24%, 26% margin rate. But if we say 18% to 22%, I'm going to be very, very happy with Bombshells' segment in that range. That's a very, very good healthy range for Bombshells. That has been our target for many years. That was the target to get to. And if we can stay in that range, I'm not going to be unhappy.

Obviously, I love the new locations running 30% plus is nice. That helps expand the margin for the couple underperforming, very older locations that we did before we really had the demographic markets figured out the way we do today. As we add more of those locations, those first two locations or so, the three locations that are underperforming will have less and less weight on the brand as well.

But I don't see any issues with that, staying in the 18% to 22% at this point. We've been able to pass on costs. I've talked to some of the guys, management there. Our labor issues that we were having, we're kind of through those for the most part. Obviously, everyone is having some short-term effect. But it was really tough when Omicron came through. We're already short and then all of a sudden, you're missing people, you're missing cooks, you're missing management, you're missing bartenders. I think that all had a little bit of effect, some in December and some of that effect we'll see in January.

But I think March will more than make up for what January did. Our March is going to be much, much stronger, I think, than our December was. And we already know that January beat October. We'll see how February does against November, and then we'll have a really good idea of where we're going. And then, that will give us our April through September kind of run rates and we'll kind of get an idea, I think, of how close we'll be between $260 million and $280 million in total revenues, which is our goal. And then as we add, I think, new projects and new clubs through acquisition as we get through the later part of that year, we'll have to see how all that plays into the numbers as well.

Q: Got you. Okay. That's great to hear. The general corporate expense was a bit higher than what we estimated here. Just wondering if there were any notable—I don't know if it's non-recurring—but any sort of items obviously as you were integrating the acquisitions. Just wondering if there was anything meaningful to call out there. And then just how should we think about the quarterly run rate for corporate expenses going forward?

Bradley Chhay - CFO

That quarter, especially our first quarter, is always impacted by the year end audit, which requires a lot of internal control work, a lot of year end SOX work. And you couple that with the due diligence work as well as any third-party work for the acquisitions of the 12 clubs. So you're going to see it ramp up a little bit higher there. On a normalized rate, I'm saying about $4.5 million for that segment on a normalized run rate.

Q: Okay. Thank you and best of luck.

Operator

[Operator Instructions] The next question is coming from Adam Wyden from ADW Capital. Your line is live.

Q: Hey, Eric, congratulations on a great quarter. This is my favorite time of the year. I only get to do this four times a year. So, I won't let all of our listeners not get a show.

But obviously, you've made some real progress in terms of improving your cost of capital relative to what it was. Now, that was a very low bar. You were trading at one point, I don't know, some stupid number. I remember that there were people shorting the stock during COVID, and it was $8 a share, and we were like this thing's going to do $10 a share of free cash flow. You obviously are trading still at a big discount to the rest of the restaurant and hospitality space. I think it might be helpful for the new people to kind of talk about your history with Bombshells and kind of the fact that you had to tinker with it a little bit and perhaps give people a sense of the cadence in terms of your store opening schedule beyond '22.

When I look at the business today, I say, well, you've got 12 locations. They're doing $6 million or $7 million. I'll call it $75 million, $80 million. You say 22% margins. When you give credit for the real estate, right, you're booking real estate through that, it's really more like 30%

margins, because you've got like 7% of sales on real estate. So, you basically got a business that's like $25 million of EBIT or whatever, between $20-$25 million of EBIT. If that was floated publicly, that would be worth more than the entire market cap. Now, of course, that's a subscale public company, but, but, but, but, but that's worth $1 billion.

And so, my question is, you've basically built this really amazing brand in Bombshells that took you some tinkering to fix it. Can you walk people through what you think the unit cadence is over the intermediate term and what you think that could be because, obviously, the strip clubs are hard for some people to invest in and we can agree to disagree on that, but I think it'd be interesting for people to really understand the long-term growth potential of the restaurant opportunity.

Eric Langan - President and CEO
The idea is for 2023 to open a store every two months and by the end of 2023 be to the point where we're actually opening a store every eight weeks and possibly even every six weeks. And that by the end of '24 going into '25, if our franchising picks up the way we think it's going to—we're talking with people now. We're getting more and more questions. We're getting more solid interest from qualified people. We've always had the interest. It's just getting qualified people interested, but we're seeing that now. So, we're talking with them.

I would like to see in 2025, us being able to open 12 or 16 locations a year by 2025 with two separate opening teams. So, you get two separate opening teams that could do a unit every six weeks or every eight weeks. And so really you do probably like a unit every 14 weeks between the opening teams. And maybe we have to have three opening teams, I don't know.

Q: Let's do some math for all the idiots that are shorting the stock after hours. Because these guys, I don't know, maybe they don't have COVID anymore, because COVID is over. Maybe they're doing drugs or Bitcoins or something. But this is the back of the envelope math I'm doing and you tell me and the rest of the viewers if I'm on some other stuff. Okay, you got six stores in 2023. Right, and you're talking calendar '23, correct?

Eric Langan - President and CEO
Yeah, calendar. Yes.

Q: So the newer stores are running higher AUVs because you've got the geographies right. And all these new stores, some of your new stores are doing close to $10 million. But let's just say that I'll make the math simple and say six stores get you $40 million of sales, fully ramped and maybe it's more than that. At a 30% operating margin with the real estate income, that's $12 million of EBITDA, organic, right just from Bombshells, fully funded off of organic, right? And then when you think about the following year, if you do one every six weeks, that's 50% growth. That'd be another $18 million of EBITDA the following year. You think you can grow your Bombshells cadence can basically grow 50% every year, so $12 million, $18 million—

Eric Langan - President and CEO
For a couple years. I don't know we can do it every year, but for the next two to three, possibly, yes, that's the plan.

Q: Okay. What I'm saying is, you've got a business that's $20 million of EBITDA, that can be $32 million the following year, and $50 million the year after that. This is going to be a meaningful part of the operation. Now that precludes you growing on the Nightclubs side. But it is your intent, I guess, in the near term to build a $50 million EBITDA business out of Bombshells. And I think—

Eric Langan - President and CEO
We think that for Bombshells to be taken seriously, $50 million is to us the magic number. That's when we have the option to decide whether Bombshells could be a standalone entity, or if Bombshells continues to fit into RCI the way the current setup is, or even looking at an acquirer that would be willing to pay us the big money for this fast growth restaurant chain. There's a lot of options that open up to us when we hit that number.

Q: We know Hooters is up for sale and they've got that stupid wings concept they're putzing around and who knows if they're going anywhere. Hooters is on the down. The math I'm doing is, if we can get to 100 locations at some point at $7 million a box, right, which isn't that crazy if you think about Buffalo Wild Wings and whatnot, you're talking about $700 million at a 30% operating margin, including real estate.

Eric Langan - President and CEO
Even if you're $6.5 million, you're close. I mean, $6.5 million a box, so you need a few extra stores. So, yeah, I think that's not an issue. 100 Bombshells. Now that we're looking in Florida, we're looking in Arizona, I don't think 100 locations is difficult at all.

Q: So, 100 locations is a $200 million EBITDA business, right? Because we're doing $20 million on 12 or 10, right? So, 2025, if we get to 100, that means it's a $200 million profit business.

Eric Langan - President and CEO
Yeah. It's going to be very significant. You can't ignore those points.

Q: The interesting thing is, you look at Bitcoin. Bitcoin went from $0.03 to $1,000 and we thought it was high and went to $50,000, right. I don't know if you've ever studied Restoration Hardware and what Gary Friedman did. Have you thought about doing a massive tender offer? Because remember, you're generating so much cash flow now, have you thought about maybe doing like a big share repurchase or something? I don't like to quote Donald Trump, but when he said he wanted to go to Washington, he said he wanted to drain the swamp. We got a swamp here and we got to drain it, because there's all these guys sloshing around. If we're not going to get our cost of capital and we're going to grow like this, have you thought about doing something more aggressive on the capital allocation front? This is absolutely insane, this math.

Eric Langan - President and CEO
We were getting prepared when the stock was down to $67 again. We were prepared to start buying stock again. In the last few days, it ran up over $10 a share. We're watching it. When it gets into our buy range, we will be buying stock. It just hasn't hit our buy range of $65. At that point we're going to buy stock because it just makes sense, even though we have enough cash on

hand now again to do the deals that we're working on. So the cash we're generating on each week basis, we don't need to just continue to build it up. We have enough in the war chest to do the things we have on our plate right now at least through May or June. As we develop and get farther into some of the acquisitions, that could change, but that's where we're at today. And we're generating cash. Our cash balances keep going up.

This quarter, I think, the second quarter, the cash flow will be a little less. We're going to pay significant income taxes this quarter, where we had a nice credit in the last quarter, so we didn't have to pay as much in taxes. Maybe our $18 million cash flow this quarter ends up only being $16 million on the same revenue. But we could also do $2 million more in revenue, $3 million more in revenue, and bring it right back up. We're going to be watchful as that goes.

Q: The fourth quarter was kind of not your seasonally strongest, which kind of brings me to your second question. If you think about $240 million of sales in the fourth quarter, and then you obviously had preopening costs and some other stuff that was burdening the margins, as you said. When I think about this business, I say, okay, you did $72 million of EBITDA effectively annualized in that quarter, right? Now you didn't have a full quarter from Lowrie. Obviously, you didn't get the synergies. Obviously, you had preopening costs. So maybe, you back that out and maybe you get back up to $75 million to $80 million, right? Plus or minus. And then when you layer on the next $40 million in sales from the return in New York, Lowrie getting fixed, and continuing getting to where you want to be in terms of—on Nightclubs, you're getting huge incremental margins, right? Bombshells less. But most of the return on growth is going to be from Nightclubs anyways—So when you think about the extra $40 million on clubs—Bombshells are basically where they are. They've been running hard the whole way—so you say another $40 million, if that's, I don't know, it could be as much as 80% incremental, but let's just be conservative and say 60%. That's another $25 million of EBITDA. This business will be in excess, assuming no additional M&A, we're going to be well in excess of $100 million of EBITDA exiting calendar '22. I would think by middle of this year, we're well in excess of $100 million of run rate EBITDA, right?

<u>Eric Langan - President and CEO</u>
We're going to be close to that. I think right now we're looking at probably, I would think we're going to be close to 82. I think we got hit for a couple million in this quarter. I think we're going to get a hit by a couple million in January, February, March or just well, January, really is when we got hit, about $2 million in December, about $2 million in January, call it 60% or 80% incremental margin. That's like $1 million in EBITDA in each of those.

So we're missing about $2 million. We were at 82. So maybe we're at 80, maybe we're 78. So we're somewhere between 78 and 82 right now on a run rate type basis. But I just really don't know for sure until we can see what March does. And we need to see what a real clean month—we shouldn't have much weather effects, we've got the March Madness going, we've got the spring fever type stuff going on—that's when we're going to really see, I think, the demand for our product and for the clubs and just people going out more. The Omicron scare will be over, and, hopefully, the whole COVID scare is over, and we get back to a more normalized operation.

Q: Also on the Lowrie front, you had a huge amount of employee turnover. There's going to be a huge jump up in utilizations.

Eric Langan - President and CEO
I think by March, yes.

Q: I'm saying, look, by the middle of the year—I don't care about January, February, right, because you're rolling—

Eric Langan - President and CEO
By the end of May. I'm thinking March, April, May is going to be huge for us. That's when we're going to be able to see—by May, we're going to know exactly what I think it's going to look like for the next 12 months. We're going to get a really good feel. Okay, hey, look we're at $80 million or no, we're at $110 million. We're going to know that, I think, in the next three months. That's when we're going to see that come to fruition.

Q: Well, you know me. I'm pretty consistent. I've been pretty good at modeling. I think my guess is by the end of May or early June, you'll be in excess of $100 million of EBITDA. That's where I'm at. I think it'll be $100 million to $110 million.

Eric Langan - President and CEO
I've done everything I can do to beat your numbers every time, even when I thought they were crazy, and we keep doing them. So I hope you're right, and it's definitely a high possibility or probability that that's where we'll be at, and we're definitely going to keep working for that.

Q: Okay, let me shift gears. We did Bombshells. We talked about that. That was helpful. We talked about the bridge on the sales. Okay, can you talk about that $20 million of inorganic M&A? Obviously, Lowrie, was kind of a shot across the bow, right? For those of you that haven't been on this call, you buying Lowrie was basically—I wouldn't say it was as crazy as David Tepper buying Jon Corzine's house after Jon Corzine blew up all his money in the Hamptons. But buying Lowrie—you had a lawsuit with him in '08. You bought the VCGH stock—this was really a coup for you. This is an asset you've been at for 15 years. You got Lowrie. It's a great metropolitan market. You're going to get the $20 million EBITDA on that. Other large owners obviously see that a sophisticated owner was willing to sell to you. How do you think about these large, multi-club, multi-MSO acquisitions? Because now you're at scale, right? The last time you had your hoo-rah in 2008, when you actually had some equity, the equity cap, you were only about $20 million of EBITDA. But now you're a far more diversified business geographically. You're now at a $100 million of EBITDA pro forma for Lowrie. How do you think about taking on another Lowrie a year, just one big deal or two big deals?

Eric Langan - President and CEO
I would love to do it. We're talking with some guys out there that have the ability to branch, not 12 clubs, but four clubs, six clubs, three clubs—deals that we're working on right now. We may have to close two deals to bring in the same type of EBITDA as we did with the Lowrie transaction. But they're out there, and we're working them. And there's some pretty decent one-off that we're working on right now as well, like 2-3-4-$5 million in a single acquisition.

Q: Boston was a big club. That fizzled, but that was a $4 million, $5 or $6 million EBITDA deal.

Eric Langan - President and CEO
I think that would have been very, very big for us. COVID just killed that deal is what happened. The owners got desperate, and then they sold the real estate, and we're not interested in the club without the real estate.

Q: You shouldn't be. You can do the math on Tootsie's and Scarlett's. Tootsie's did $20 million EBITDA, $25 million. Those are big, unique assets, right? Could there be another Tootsie's in the United States that's not in Vegas?

Eric Langan - President and CEO
I recently found a club that's another Scarlett's, at least, another Rick's New York, that we're talking with the owners on. Got to go take a look at it. I was very surprised. The problem with the private clubs is you don't know what their numbers are until you get under NDA and they actually really give them to you. And you get tax returns, and you go through and go, wow, you guys are doing those kinds of numbers. I had no idea. And so those are the things we're finding right now. I'll say on the call to all the owners out there that might be listening. We're very interested in larger acquisitions. It takes us just as much energy and effort to buy one club as it takes to buy 12 clubs.

Q: I'll send a message to all the club owners themselves, which is, I can personally attest to the fact that Eric Langan is a super talented capital allocator. Any club owner should look at Troy Lowrie, and look really, really hard. Because the stock is still trading at a very low multiple, and there is going to be a time hopefully in the next two to five years where we're going to trade at a multiple instructive of our ability to allocate capital and grow. Because the reality is that a business of this scale—the guys at Noble put out an interesting report. There're 2,200 clubs in the United States. We only are at 49. So we're 2% penetrated. It's just math, right. There's another 98% of clubs. You're telling me there isn't another Tootsie's out there? There's got to be—and it's an incredible opportunity. Because of ESG and private equity and this and that, we are the only game in town, and I am convinced that at some point we are going to trade in a multiple instructive of our ability to allocate capital and grow.

I encourage you to keep hitting these investor days and getting in front of people and keep doing the great work and, we'll go from there. Last thing. Can you talk a little bit about the financial metrics of AdmireMe? I almost forgot about this. If you have 1,000 people, and if the average girl is $10 a month, have you thought about kind of pencil to paper? I know you guys get some revenue share of the subscriptions.

Eric Langan - President and CEO
I think for the average girl, maybe it's $200, maybe it's $2,000, I don't know. But if it's $200, and I get 1,000 girls on there, all of a sudden, I'm doing my $200,000 a month or $2.4 million a year to kick off, and if I can get that done in the first 60 to 90 days, and that's my ramp up, and the next thing, I have 10,000 girls on there, I think that it's going to be a very, very powerful and significant site for us.

Plus, it's going to increase our brick-and-mortar, I think, frequency. We have a lot of really pretty girls that work for us and some guys get intimidated. But they can find them on the internet, they can chat with them, message back and forth, maybe get a little more comfortable, and then be able to come into the club. In fact, I was talking with a guy last night. He goes, man, I'm really shy. I said, well, you want me to go get that girl and let me go talk to her for you to come over to the table. No, no, no, don't bring her over, don't bring her over. I'm like, okay. He was, I want to get to know more about her first. I said, well, that's what AdmireMe is all about. I said, you'll be able to do that. And so it kind of gave me a little bit of insight to seeing it work.

So, I think it's going to work very, very well. We got to get it up and get it running, and we're very close. The credit card processing should go live on the site here in the next week or so. Everything's approved. They're just working out all the APIs and all the security with a security company and all that right now. That should all be up and operating here in the next, say, week or two weeks, and probably we'll do some quick testing of it and do a very soft launch within two weeks of that, I think.

By the 10th of March or 15th of March, we'll definitely have basically a beta site running where we're allowing customers in. It'll be password-protected. It'll be invite-only where the girls that we're loading onto the site can invite their customers in. They'll be the first ones on the site. And then once that's running smoothly, we'll open it to the general public.

Q: Good stuff, Eric. Keep fighting the good fight, and we appreciate the hard work.

Eric Langan - President and CEO
Yeah. Thank you, Adam.

Operator
Are there any final questions? This is the last chance for questions. [Operator Instructions]

Gary Fishman - Investor Relations
John, this is Gary. We got a couple questions that have been emailed while we're waiting to see whether anybody else has any questions. Eric, what's the significance of the $7 million acquisition of Scarlett's Cabaret Miami property? It's a question from Jonathan Hollander of Chesapeake Advisory.

Eric Langan - President and CEO
Sure. That's an 8% cap rate based on the rent at the time of closing. The rent goes up by CPI every year. So we just had a 6% increase that would have went into effect in January. If you consider a 3% CPI over the next 10 years, it becomes a 10.74% cap rate on what the rents would be, and we own the property. Now we control our destiny at that location forever.

There was 30 years left on the lease so we weren't at any real risk. Originally, they wanted $9.5 million for that property. We told them we'll wait. We'll stick with the lease. Last year they came down to $8 million. This year they came down to $7 million, and we couldn't turn down $7 million. With an 8% cap rate and almost 11% return over the next 10 years on that property, we couldn't turn it down. We had to buy it. We believe the property will appraise for about $7.8 million or $7.9 million so it's worth probably about 10% more than we paid in cash.

The main reason they discounted so quickly as we literally closed that deal in two days and then escrowed part of the money until we got actual title clearance. So it worked out very well. That deal is completely closed now. We have full title insurance and everything else. It's a significant pickup for us and it feeds very well into what we pay for real estate normally.

Gary Fishman - Investor Relations
Great, thanks. And one last one from Antonis Protopapas and his family office. For our high margin service revenue, is there a story behind that pop or just the reopening? What was the driver—mostly cover charges, executive rooms, et cetera?

Eric Langan - President and CEO
It was mainly New York being back open full time and customers coming back in. And we saw that through October and November. And then by probably the second week of December as Omicron hit New York very hard, especially in our staff, that we started to see that decline a little bit again through about the second week of January. And since the second week of January, we're now starting to see that revenue back into the club again in New York. Also, Minnesota did very well through November and December. They had a slow down at the end of December, early January, similar to Texas, where the virus hit those markets. Those markets are now recovering.

We have had some weather issues this first week of February, but I'm very optimistic. We have a bottle reservation system that we use, and I've looked at some of the numbers there. Those numbers are getting better for reservations going through the end of February. So I think we're going to see that service revenue bounce back and get back on course to where it was through October, November, and actually in March, I think we're going to see all that exceed. I think service revenues will grow to over 30% of revenues again in a short period of time.

Gary Fishman - Investor Relations
We just got another question from Steve Martin. Has the competitive landscape changed in New York City post-COVID?

Eric Langan - President and CEO
It's gotten better for us. Two major 10,000 square foot clubs didn't reopen. The Executive Club on 49th and the Scores on 28th Street did not reopen. That's 20,000 square feet of adult space that basically went away in New York City. But that's probably good, because I think half of our hedge fund managers and stuff all moved to Florida.

Tootsie's is doing very well. New York is missing a few customers, but it's nice when they come back to visit. When they come back and work in the city, they're here for typically three to four days, and we're seeing them for two or three days in the club. It's working out very well for us in that regard. And that's what I think we need to see as the weather gets better and the ice and snow, we get past that in the next few weeks. I know the groundhog saw a shadow so we're supposed to see a little more winter here. But I think by March we're going to be in great, great shape.

<u>Gary Fishman - Investor Relations</u>

Okay. Thanks, Eric. John, it looks like we have no more questioners, and we're almost hitting an hour or so why don't I wrap up?

Thank you, Eric and Bradley. For those of you who joined us late, you can meet management tonight at Rick's Cabaret New York starting at 6 o'clock at 50 West 33rd between Fifth and Broadway. If you haven't RSVP-ed, ask for Eric or me at the door.

We'd like to welcome Noble Capital Markets, which is now following RCI along with Sidoti & Company. We will be at Noble's Small Cap Conference in Hollywood, Florida, April 19th through the 21^{st}.

On behalf of Eric, Bradley, the company and our subsidiaries, thank you and good night. Stay safe, stay healthy and as always, please visit one of our clubs or restaurants.

<u>Eric Langan - President and CEO</u>

Thank you.

<u>Operator</u>

Thank you, ladies and gentlemen. This does conclude today's conference call. You may disconnect your phone lines at this time and have a wonderful day. Thank you for your participation.