



**( 281) 397-6730**

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of July 31, 2015, 10,257,323 shares of the registrant's Common Stock were outstanding.

## NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, among other things, statements regarding plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. Forward-looking statements may appear throughout this report, including without limitation, in Part I, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements generally can be identified by words such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “will be,” “will continue,” “will likely result,” and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q and those discussed in other documents we file with the Securities and Exchange Commission (“SEC”). Important factors that in our view could cause material adverse affects on our financial condition and results of operations include, but are not limited to, the risks and uncertainties related to our future operational and financial results, competitive factors, the timing of the openings of other clubs, the availability of acceptable financing to fund corporate expansion efforts, our dependence on key personnel, the ability to manage operations and the future operational strength of management, and the laws governing the operation of adult entertainment businesses. We undertake no obligation to revise or publicly release the results of any revision to any forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

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

RCI HOSPITALITY HOLDINGS, INC.

TABLE OF CONTENTS

PART I <u>FINANCIAL INFORMATION</u>	1
Item 1. <u>Financial Statements</u>	1
<u>Consolidated Balance Sheets as of June 30, 2015 and September 30, 2014</u>	1
<u>Consolidated Statements of Income (unaudited) for the three and nine months ended June 30, 2015 and 2014</u>	3
<u>Consolidated Statements of Comprehensive Income (unaudited) for the three and nine months ended June 30, 2015 and 2014</u>	4
<u>Consolidated Statements of Cash Flows (unaudited) for the nine months ended June 30, 2015 and 2014</u>	5
<u>Notes to Consolidated Financial Statements</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	30
Item 4. <u>Controls and Procedures</u>	31
PART II <u>OTHER INFORMATION</u>	31
Item 1. <u>Legal Proceedings</u>	31
Item 1A. <u>Risk Factors</u>	31
Item 6. <u>Exhibits</u>	32
<u>Signatures</u>	33

**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.**

## RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

ASSETS

(in thousands, except per share data)	<b>June 30, 2015 (UNAUDITED)</b>	<b>September 30, 2014</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 14,730	\$ 9,964
Accounts receivable:		
Trade, net	1,439	1,060
Other, net	815	685
Marketable securities	604	596
Inventories	2,517	1,879
Deferred tax asset	3,791	5,378
Prepaid expenses and other current assets	3,153	3,789
Total current assets	27,049	23,351
Property and equipment, net	121,150	113,962
Other assets:		
Goodwill	47,316	43,374
Other indefinite lived intangibles	56,175	53,968
Definite lived intangibles	10,645	675
Other	2,650	3,812
Total other assets	116,786	101,829
Total assets	\$ 264,985	\$ 239,142

See accompanying notes to unaudited consolidated financial statements.



## RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

## LIABILITIES AND STOCKHOLDERS' EQUITY

<b>(in thousands, except per share data)</b>	<b>June 30, 2015</b>	<b>September 30, 2014</b>
	<b>(UNAUDITED)</b>	
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 2,848	\$ 2,198
Accrued liabilities	13,625	9,195
Texas patron tax liability	935	15,486
Current portion of long-term debt	11,390	12,315
Total current liabilities	28,798	39,194
Deferred tax liability	29,662	27,688
Other long-term liabilities	4,562	924
Long-term debt	72,971	58,037
Total liabilities	135,993	125,843
Commitments and contingencies		
<b>PERMANENT STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$.10 par, 1,000 shares authorized; none issued and outstanding	-	-
Common stock, \$.01 par, 20,000 shares authorized; 10,257 and 10,067 shares issued and outstanding, respectively	103	101
Additional paid-in capital	70,515	66,727
Accumulated other comprehensive income	99	91
Retained earnings	52,156	43,370
Total RCIHH's permanent stockholders' equity	122,873	110,289
Noncontrolling interests	6,119	3,010
Total permanent stockholders' equity	128,992	113,299
Total liabilities and stockholders' equity	\$ 264,985	\$ 239,142

See accompanying notes to unaudited consolidated financial statements.





## RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE NINE MONTHS ENDED JUNE 30,	
	2015	2014	2015	2014
	(UNAUDITED)		(UNAUDITED)	
Revenues:				
Sales of alcoholic beverages	\$ 15,148	\$ 13,626	\$ 45,963	\$ 38,300
Sales of food and merchandise	5,049	4,076	15,515	11,478
Service revenues	13,870	14,035	42,623	41,112
Other	1,694	1,606	5,557	4,746
Total revenues	35,761	33,343	109,658	95,636
Operating expenses:				
Cost of goods sold	5,033	4,295	15,525	12,083
Salaries and wages	8,176	7,219	24,323	20,650
Stock compensation	120	2	360	156
Other general and administrative:				
Taxes and permits	5,444	5,150	16,546	14,707
Charge card fees	562	479	1,653	1,356
Rent	1,189	1,315	3,514	3,699
Legal and professional	939	1,206	2,962	2,420
Advertising and marketing	1,506	1,420	4,185	4,111
Insurance	866	1,014	2,487	2,785
Utilities	727	650	2,169	1,891
Depreciation and amortization	1,923	1,532	5,454	4,438
Loss on sale of property	178	334	160	248
Impairment of assets	-	-	1,358	-
Settlement of lawsuits and other one-time costs	10	3,233	10,560	3,503
Gain on settlement of patron tax	(8,167 )	-	(8,167 )	-
Other	3,103	2,602	8,893	7,624
Total operating expenses	21,609	30,451	91,982	79,671
Operating income	14,152	2,892	17,676	15,965
Other income (expense):				
Interest income	-	-	39	112
Interest expense	(1,630 )	(2,060 )	(5,032 )	(5,996 )
Gain from original investment in Drink Robust	-	-	577	-
Income before income taxes	12,522	832	13,260	10,081
Income taxes	4,442	203	5,023	3,448
Net income	8,080	629	8,237	6,633
Less: net (income) loss attributable to noncontrolling interests	187	62	549	183
Net income attributable to RCI Hospitality Holdings, Inc.	\$ 8,267	\$ 691	\$ 8,786	\$ 6,816

Edgar Filing: RCI HOSPITALITY HOLDINGS, INC. - Form 10-Q

Basic earnings per share attributable to RCIHH's  
shareholders:

Net income	\$ 0.81	\$ 0.07	\$ 0.86	\$ 0.70
------------	---------	---------	---------	---------

Diluted earnings per share attributable to RCIHH's  
shareholders:

Net income	\$ 0.78	\$ 0.07	\$ 0.85	\$ 0.69
------------	---------	---------	---------	---------

Weighted average number of common shares  
outstanding:

Basic	10,245	9,883	10,262	9,695
Diluted	10,707	9,968	10,724	9,922

See accompanying notes to unaudited consolidated financial statements.

## RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share data)	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE NINE MONTHS ENDED JUNE 30,	
	2015	2014	2015	2014
	(UNAUDITED)		(UNAUDITED)	
Net income	\$ 8,080	\$ 629	\$ 8,237	\$ 6,633
Other comprehensive income:				
Unrealized holding gain (loss) on securities available for sale	(5 )	13	8	31
Comprehensive income	8,075	642	8,245	6,664
Less: net (income) loss attributable to noncontrolling interests	187	62	549	183
Comprehensive income to common stockholders	\$ 8,262	\$ 704	\$ 8,794	\$ 6,847

See accompanying notes to unaudited consolidated financial statements.

## RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

**(in thousands, except per share data)**FOR THE NINE MONTHS  
ENDED JUNE 30,  
2015            2014  
(UNAUDITED)

## CASH FLOWS FROM OPERATING ACTIVITIES:

Net income	\$ 8,237	\$ 6,633
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	5,454	4,438
Deferred taxes	3,459	225
Amortization of note discount	47	65
Beneficial conversion	8	-
Deferred rents	(24 )	(17 )
Stock compensation expense	360	156
Loss on sale of assets and impairment of assets	1,518	248
Gain on settlement of patron tax	(8,167 )	-
Gain from original investment in Drink Robust	(577 )	-
Changes in operating assets and liabilities:		
Accounts receivable	(439 )	(532 )
Inventories	(410 )	(324 )
Prepaid expenses and other assets	1,340	(1,286 )
Accounts payable and accrued liabilities	7,474	4,192
Cash provided by operating activities	18,280	13,798

## CASH FLOWS FROM INVESTING ACTIVITIES:

Additions to property and equipment	(3,967 )	(11,822 )
Proceeds from sale of assets	-	223
Acquisition of development rights in New York building	-	(5,325 )
Acquisition of businesses, net of cash acquired	(2,217 )	(500 )
Net cash used by investing activities	(6,184 )	(17,424 )

## CASH FLOWS FROM FINANCING ACTIVITIES:

Payments on long-term debt	(9,916 )	(5,899 )
Proceeds from long-term debt	4,957	7,025
Exercise of stock options	87	3,126
Purchase of treasury stock	(2,296 )	-
Distribution to minority interests	(162 )	(162 )
Cash provided by (used in) financing activities	(7,330 )	4,090

NET INCREASE IN CASH	4,766	464
CASH AT BEGINNING OF PERIOD	9,964	10,638
CASH AT END OF PERIOD	\$ 14,730	\$ 11,102
CASH PAID DURING PERIOD FOR:		

Edgar Filing: RCI HOSPITALITY HOLDINGS, INC. - Form 10-Q

Interest	\$ 4,687	\$ 5,618
Income taxes	\$ 2,877	\$ 2,553

See accompanying notes to unaudited consolidated financial statements.

Non-cash transactions:

During the nine months ended June 30, 2015, the Company incurred \$3.2 million in seller-financed long-term debt in connection with the acquisition of real estate.

During the nine months ended June 30, 2015, the Company issued 200,000 shares of common stock for the acquisition of a controlling interest in Drink Robust, Inc.

As a result of the settlement of the patron tax matter, the Company has reclassified the resulting \$7.2 million to long-term debt as of June 30, 2015.

During the nine months ended June 30, 2015, the Company purchased and retired 225,280 common treasury shares. The cost of these shares was \$2.3 million.

During the nine months ended June 30, 2015, the Company converted debt principal and interest valued at \$2.1 million into 205,067 common shares.

During the nine months ended June 30, 2014, the Company incurred \$4.9 million in seller-financed long-term debt in connection with the acquisition of real estate and an aircraft.

During the nine months ended June 30, 2014, the Company converted debt principal and interest valued at \$2.1 million into 211,443 common shares.

See accompanying notes to unaudited consolidated financial statements.

**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2015**

**(UNAUDITED)**

**1. BASIS OF PRESENTATION AND NAME CHANGE**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q of Regulation S-X. They do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to the consolidated financial statements for the year ended September 30, 2014 included in the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission. The interim unaudited 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 nine months ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending September 30, 2015.

At the Company’s Annual Meeting of Stockholders on August 6, 2014, stockholders approved changing its name to RCI Hospitality Holdings, Inc. (“RCIHH”).

**2. RECENT ACCOUNTING STANDARDS AND PRONOUNCEMENTS**

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), which supersedes nearly all existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing GAAP. The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is currently evaluating the impact of our pending adoption of ASU 2014-09 on its consolidated financial

statements and have not yet determined the method by which it will adopt the standard in fiscal year 2018.

### 3. SIGNIFICANT ACCOUNTING POLICIES

Following are certain remarkable accounting principles and disclosures.

#### Fair Value Accounting

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

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

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

The Company classifies its marketable securities as available-for-sale, which are reported at fair value. Unrealized holding gains and losses, net of the related income tax effect, if any, on available-for-sale securities are excluded from income and are reported as accumulated other comprehensive income in stockholders' equity. Realized gains and losses from securities classified as available-for-sale are included in income.

The Company measures the fair value of its marketable securities based on quoted prices for identical securities in active markets, or Level 1 inputs. As of June 30, 2015, available-for-sale securities consisted of the following:

(in thousands)	Cost	Gross Unrealized	Fair
Available for Sale	Basis	Gains	Value
Tax-Advantaged Bond Fund	\$ 505	\$ 99	\$ 604



**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2015****(UNAUDITED)****3. SIGNIFICANT ACCOUNTING POLICIES - continued**

The Company reviews its marketable securities to determine whether a decline in fair value of a security below the cost basis is other than temporary. Should the decline be considered other than temporary, the Company writes down the cost basis of the security and include the loss in current earnings as opposed to an unrealized holding loss. No losses were recognized during the quarter ended June 30, 2015.

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

(in thousands)	Carrying			
June 30, 2015	Amount	Level 1	Level 2	Level 3
Marketable securities	\$ 604	\$ 604	\$ -	\$ -

(in thousands)	Carrying			
September 30, 2014	Amount	Level 1	Level 2	Level 3
Marketable securities	\$ 596	\$ 596	\$ -	\$ -

**Reclassifications**

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

**4. STOCK OPTIONS AND STOCK-BASED EMPLOYEE COMPENSATION*****Employee and Director Stock Option Plans***

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

The compensation costs recognized for the three months ended June 30, 2015 and 2014 were \$120,012 and \$2,922, respectively, and were \$360,036 and \$156,449 for the nine months then ended, respectively. There were 10,000 stock option exercises aggregating \$87,000 respectively, during the three and nine months ended June 30, 2015. There were 269,665 and 369,665 stock option exercises aggregating \$2.3 million and \$3.1 million, respectively, during the three and nine months ended June 30, 2014. There were no stock option grants for the three and nine months ended June 30, 2015.

### *Stock Option Activity*

The following is a summary of all stock option transactions for the nine months ended June 30, 2015:

(in thousands, except for per share and year information)	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of September 30, 2014	10	\$ 8.70		
Granted	-	-		
Cancelled or expired	-	-		
Exercised	(10 )	8.70		
Outstanding as of June 30, 2015	-	\$ -	-	\$ -
Options exercisable as of June 30, 2015	-	\$ -	-	\$ -

**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2015****(UNAUDITED)****5. GOODWILL AND OTHER INTANGIBLES**

Following are the changes in the carrying amounts of intangibles for the nine months ended June 30, 2015 and 2014:

(in thousands)	2015			2014		
	Definite-Lived Intangibles	Licenses	Goodwill	Definite-Lived Intangibles	Licenses	Goodwill
Beginning balance	\$ 729	\$ 53,968	\$ 43,374	\$ 1,065	\$ 54,966	\$ 43,987
Intangibles acquired	10,375	3,565	3,891	-	-	-
Impairment		(1,358 )	-	-	-	-
Other	(459 )	-	51	(171 )	265	-
Ending balance	\$ 10,645	\$ 56,175	\$ 47,316	\$ 894	\$ 55,231	\$ 43,987

**6. LONG-TERM DEBT**

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

On May 4, 2015 a Company subsidiary purchased The Seville gentlemen's club in Minneapolis Minnesota. As part of the transaction, another subsidiary also purchased the club's real estate. Total consideration of \$8.5 million consisted of \$4.5 million for the assets of the club business and \$4.0 million for the real estate. Payment was made through bank financing of \$5.7 million at 5.5% interest, seller financing of \$1.8 million at 6% and cash of \$1.1 million.

Edgar Filing: RCI HOSPITALITY HOLDINGS, INC. - Form 10-Q

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

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

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

On October 15, 2013, the Company sold to certain investors (i) 9% Convertible Debentures with an aggregate principal amount of \$4,525,000 (the "Debentures"), under the terms and conditions set forth in the Debentures, and (ii) warrants to purchase a total of 72,400 shares of the Company's common stock (the "Warrants"), under the terms and conditions set forth in the Warrants. Each of the Debentures has a term of three years, is convertible into shares of our common stock at a conversion price of \$12.50 per share (subject to adjustment), and has an annual interest rate of 9%, with one initial payment of interest only due April 15, 2014. Thereafter, the principal amount is payable in 10 equal quarterly principal payments, which amounts to a total of \$452,500, plus accrued and unpaid interest. Six months after the issue date of the Debentures, we have the right to redeem the Debentures if the Company's common stock has a closing price of \$16.25 (subject to adjustment) for 20 consecutive trading days. The Warrants have an exercise price of \$12.50 per share (subject to adjustment) and expire on October 15, 2016. In the event there is an effective registration statement registering the shares of common stock underlying the Warrants, we have the right to require exercise of the Warrants if our common stock has a closing price of \$16.25 (subject to adjustment) for 20 consecutive trading days. The Company sold the Debentures and Warrants to the investors in a private transaction and received consideration of \$4,525,000. An adviser to the Company received compensation in the amount of \$271,500 in connection with advising the Company regarding the sale of the Debentures and Warrants.

The fair value of the warrants was estimated to be \$105,318 in accordance with GAAP, using a Black-Scholes option-pricing model using the following weighted average assumptions:

Volatility	28.4	%
Expected life	1.5	years
Expected dividend yield	-	
Risk free rate	.33	%

**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2015**

**(UNAUDITED)**

**6. LONG-TERM DEBT – continued**

The cost of the warrants has been recognized as a discount on the related debt and was amortized over the life of the debt.

In October 2013 the Company borrowed \$2.5 million from an individual. The note is collateralized by a second lien on the Company's Miami nightclub, bears interest at 13% and interest only is payable monthly until the principal matures in 36 months.

In December 2013 the Company purchased an aircraft for \$4.3 million which was partially financed by a \$3.6 million note to a bank. The note is payable \$40,654 monthly, including interest at 7.45% until February 2017 when the entire principal balance becomes due.

In May 2014, the Company acquired certain real estate in Houston, Texas for the purpose of constructing a corporate headquarters building. The cost of the land was \$707,000 and was partially financed with a \$531,000 note, payable \$18,151 per quarter until May 2019, including interest at 6.5%.

In October 2013, the Company acquired certain real estate in Beaumont, Texas. The cost of the property was \$850,000 and was partially financed with a \$700,000 note, payable \$10,565 per month until October 2020.

**7. COMMON STOCK**

During the nine months ended June 30, 2015, the Company purchased and retired 225,280 common treasury shares. The cost of these shares was \$2.3 million. These shares have been retired.

During the nine months ended June 30, 2014, the Company converted debt principal and interest valued at \$2.1 million into 211,443 common shares.

During the nine months ended June 30, 2015, the Company converted debt principal and interest valued at \$2.1 million into 205,067 common shares.

During the nine months ended June 30, 2015, the Company issued 200,000 shares of common stock for the acquisition of a controlling interest in Drink Robust, Inc.

## **8. EARNINGS PER SHARE**

The Company computes earnings per share (“EPS”) in accordance with GAAP. GAAP provides for the calculation of basic and diluted earnings per share. Basic earnings per share includes no dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of the Company.

Potential common stock shares consist of shares that may arise from outstanding dilutive common stock warrants and options (the number of which is computed using the “treasury stock method”) and from outstanding convertible debentures (the number of which is computed using the “if converted method”).

**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2015****(UNAUDITED)****8. EARNINGS PER SHARE (“EPS”) - continued**

Diluted EPS considers the potential dilution that could occur if the Company’s outstanding common stock options, warrants and convertible debentures were converted into common stock that then shared in the Company’s earnings (as adjusted for interest expense that would no longer occur if the debentures were converted).

	FOR THE QUARTER ENDED JUNE 30,		FOR THE NINE MONTHS ENDED JUNE 30,	
	2015	2014	2015	2014
Basic earnings per share:				
Net income attributable to RCIHH shareholders	\$ 8,267	\$ 691	\$ 8,786	\$ 6,816
Average number of common shares outstanding	10,245	9,883	10,262	9,695
Basic earnings per share - net income attributable to RCIHH shareholders	\$ 0.81	\$ 0.07	\$ 0.86	\$ 0.70
Diluted earnings per share:				
Net income attributable to RCIHH shareholders	\$ 8,267	\$ 691	\$ 8,786	\$ 6,816
Adjustment to net earnings from assumed conversion of debentures (1)	118	-	356	60
Adjusted net income attributable to RCIHH shareholders	\$ 8,385	\$ 691	\$ 9,142	\$ 6,876
Average number of common shares outstanding:				
Common shares outstanding	10,245	9,883	10,262	9,695
Potential dilutive shares resulting from exercise of warrants and options (2)	-	85	-	96
Potential dilutive shares resulting from conversion of debentures (3)	462	-	462	131
Total average number of common shares outstanding used for dilution	10,707	9,968	10,724	9,922
Diluted earnings per share - net income attributable to RCIHH shareholders	\$ 0.78	\$ 0.07	\$ 0.85	\$ 0.69

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

(2) All outstanding warrants and options were considered for the EPS computation.

(3) Convertible debentures (principal and accrued interest) outstanding at June 30, 2015 and 2014 totaling \$5.3 million and \$10.5 million, respectively, were convertible into common stock at a price of \$10.00 to \$12.50 per share each year. Potential dilutive shares amounting to 462,000 for each of the three and nine month periods ended June 30, 2015 have been excluded from earnings per share due to being anti-dilutive. Potential dilutive shares of 1.5 million for each of the three and nine month periods ended June 30, 2014, have been excluded from earnings per share due to being anti-dilutive.

\* EPS may not foot due to rounding.



**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2015**

**(UNAUDITED)**

**9. ACQUISITIONS**

**Nine Months Ended June 30, 2015**

On May 4, 2015 a Company subsidiary purchased The Seville gentlemen’s club in Minneapolis Minnesota. As part of the transaction, another subsidiary also purchased the club’s real estate. Total consideration of \$8.5 million consisted of \$4.5 million for the assets of the club business and \$4.0 million for the real estate. Payment was made through bank financing of \$5.7 million at 5.5% interest, seller financing of \$1.8 million at 6% and cash of \$1.1 million.

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

(in thousands)

Buildings and land	\$4,050
Furniture and fixtures	250
Inventory	109
Goodwill	3,891
Noncompete	200
Net assets	\$8,500

On October 30, 2014, a 51% owned subsidiary of the Company (“Robust”) acquired certain assets and liabilities of Robust Energy LLC for \$200,000 in cash and 200,000 shares of its restricted common stock for a total purchase price of \$5.0 million. The Company has also agreed to issue 50,000 shares of RCIHH common stock each to the two principals of Robust Energy LLC if Robust has net income of at least \$1 million during the 2015 calendar year. The principals entered into a Lock-Up Agreement with the Company in connection with the issuance by the Company of its shares of common stock as explained above, which will provide that none of the shares will be sold for a period of one year after the date of issuance and, thereafter, neither principal will sell more than 1/6th of their respective shares per month that they receive in connection herewith. Robust is an energy drink distributor, targeting the on premises bar and mixer market.

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

(in thousands)	
Inventory and accounts receivable	\$501
Equipment, furniture and fixture	356
Definite-lived intangible	10,275
Accounts payable	(1,196 )
Notes payable	(963 )
Noncontrolling interest	(3,888 )
Net assets	\$5,085

In accordance with GAAP, the Company recorded a gain of approximately \$577,000 on the value of its earlier 15% investment in this company.

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

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

(in thousands)

Buildings and land	\$3,130
Furniture and fixtures	20
Inventory	4
SOB license	3,566
Noncompete	100
Net assets	\$6,820

**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2015**

**(UNAUDITED)**

**9. ACQUISITIONS - continued**

**Nine Months Ended June 30, 2014**

In October 2013, the Company purchased 49 percent of a corporation that operates the Dallas club “PT’s Platinum” and also acquired the building and personal property. Total cost of the transaction was \$500,000. This subsidiary is being consolidated in the Company’s consolidated financial statements, effective as of the date of the purchase.

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

Buildings and land	\$ 350
Property and equipment	20
SOB license	265
Minority interest	(135)
Net assets	\$500

**10. INCOME TAXES**

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

For the Three Months		For the Nine Months	
Ended June 30,		Ended June 30,	
2015	2014	2015	2014

Edgar Filing: RCI HOSPITALITY HOLDINGS, INC. - Form 10-Q

Computed expected tax expense	\$ 4,257	\$ 283	\$ 4,508	\$ 3,428
State income taxes	18	76	166	181
Stock option disqualifying dispositions and other permanent differences	167	(156 )	349	(161 )
Total income tax expense	\$ 4,442	\$ 203	\$ 5,023	\$ 3,448

Included in the Company's deferred tax liabilities at June 30, 2015 is approximately \$17.2 million representing the tax effect of indefinite lived intangible assets from club acquisitions which are not deductible for tax purposes. These deferred tax liabilities will remain in the Company's balance sheet until the related clubs are sold.

**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2015**

**(UNAUDITED)**

**11. COMMITMENTS AND CONTINGENCIES**

**Legal Matters**

Texas Patron Tax

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

New York Settlement

On April 1, 2015, we and our subsidiaries, RCI Entertainment (New York), Inc. and Peregrine Enterprises, Inc., entered into an agreement to settle in full a New York based federal wage and hour class action case filed in the United States District Court for the Southern District of New York. The settlement has been filed with the court for preliminary approval. Trial was scheduled to begin April 27, 2015. Under terms of the agreement, RCI Entertainment (New York), Inc. and Peregrine Enterprises, Inc. will make up to \$15 million available to class members and their attorneys. The actual amount paid will be determined based on the number of class members responding by the end of a three-month notice period, with final court approval expected sometime after that. Any unclaimed checks or payments will revert back to our subsidiaries. Based on the current schedule, an initial payment of \$1,833,333 will be made in approximately five months, with two subsequent payments of \$1,833,333 each being made in equal annual installments. As part of the settlement, we were required to guarantee the obligations of RCI Entertainment (New

York), Inc. and Peregrine Enterprises, Inc. under the settlement.

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

In accordance with GAAP, the Company has accrued \$10.3 million as of June 30, 2015 as the estimated liability for its obligations under the settlement. This is included as accrued liabilities in the consolidated balance sheets.

#### 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. Since the expiration of the order the lawsuits have resumed. We are funding 100% of the costs of litigation and will seek reimbursement from the bankruptcy receiver.

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

Settlement of lawsuits and other one-time costs include no payments during the quarters ended June 30, 2015 and 2014 in settlements with claimants which were unpaid by our general liability insurance carrier.

**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2015**

**(UNAUDITED)**

**11. COMMITMENTS AND CONTINGENCIES - continued**

Settlement of lawsuits and other one-time costs for the nine months ended June 30, 2014 include a \$2 million settlement with a claimant which was unpaid by our general liability insurance carrier. We will be filing a claim with the insurance company's estate and with the state's insurance fund for this settlement.

**12. WARRANTS ISSUED**

In February 2014, the Company issued warrants to acquire 100,000 shares of Company common shares to a financial adviser. The exercise price of the warrants was \$11.77, the market price of the shares at the time. The warrants were exercisable immediately and expire in two years. The fair value of the warrants, which was entirely charged to expense upon issuance, was estimated to be \$147,683 in accordance with FASB ASC 820, *Fair Value Measurements*, using a Black-Scholes option-pricing model using the following weighted average assumptions:

Volatility	31.5	%
Expected life	1.0	years
Expected dividend yield	-	
Risk free rate	.12	%

**13. RESTRICTED STOCK ISSUANCE**

In July 2014, the Company granted to an executive officer and an officer of a subsidiary an aggregate total of 96,325 shares of restricted stock. The total grant date fair value of all of these awards was \$938,478 and vest in two years. Restricted stock awards are awards of common stock that are subject to restrictions on transfer and to a risk of forfeiture if the awardee terminates employment with the Company prior to the lapse of the restrictions. The fair value of such stock was determined using the closing price on the grant date and compensation expense is recorded over the



applicable vesting periods. Forfeitures are recognized as a reversal of expense of any unvested amounts in the period incurred. Unamortized expense amounted to \$500,513 at June 30, 2015. The compensation cost recognized for the nine months ended June 30, 2015 was \$360,036.

**RCI HOSPITALITY HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2015****(UNAUDITED)****14. SEGMENT INFORMATION**

The Company is engaged in adult nightclubs and Bombshells Restaurants and Bars. The Company has identified such segments based on management responsibility and the nature of the Company's products, services and costs. There are no major distinctions in geographical areas served as all operations are in the United States. The Company measures segment profit (loss) as income (loss) from operations. Total assets are those assets controlled by each reportable segment. The other category below includes our media, Robust and internet divisions.

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
Business segment sales:				
Night clubs	\$ 30,568	\$ 31,486	\$ 93,564	\$ 91,037
Bombshells	4,789	1,585	14,510	3,668
Other	404	272	1,584	931
	\$ 35,761	\$ 33,343	\$ 109,658	\$ 95,636
Business segment operating income:				
Night clubs	\$ 17,271	\$ 8,526	\$ 26,000	\$ 25,947
Bombshells	369	(170 )	1,480	(268 )
Other	(682 )	(220 )	(1,995 )	(521 )
General corporate	(2,806 )	(5,244 )	(7,809 )	(9,193 )
	\$ 14,152	\$ 2,892	\$ 17,676	\$ 15,965
Business segment capital expenditures:				
Night clubs	\$ 207	\$ 1,744	\$ 882	\$ 6,109
Bombshells	300	1,827	1,853	4,979
Other	529	3	973	3
General Corporate	62	50	259	731
	\$ 1,098	\$ 3,624	\$ 3,967	\$ 11,822

## Business segment depreciation and amortization:

Night clubs	\$ 823	\$ 1,297	\$ 3,731	\$ 3,802
Bombshells	229	62	502	115
Other	733	4	813	54
General corporate	138	169	408	467
	\$ 1,923	\$ 1,532	\$ 5,454	\$ 4,438

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.

**15. SUBSEQUENT EVENTS**

On July 28, 2015, a subsidiary of the Company acquired the building in which the Company's Miami Gardens, Florida nightclub operates. The cost was \$15,300,000 and was purchased with an \$11,325,000 note, payable in monthly installments of approximately \$78,000, including interest at 5.45% and matures in five years and the balance with cash. The building has several other third-party tenants in addition to the Company's nightclub.

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

The following discussion should be read in conjunction with our audited consolidated financial statements and related notes thereto included in this quarterly report.

**GENERAL**

At the Company’s Annual Meeting of Stockholders on August 6, 2014, its name was officially changed from Rick’s Cabaret International, Inc. to RCI Hospitality Holdings, Inc. RCI Hospitality Holdings, Inc. (sometimes referred to as RCIHH herein) was incorporated in the State of Texas in 1994. Through our subsidiaries, as of July 31, 2015, we operate a total of forty-five establishments that offer live adult entertainment, and/or restaurant and bar operations. We have two reportable segments, nightclubs and Bombshells Restaurants and Bars. RCI Hospitality Holdings, Inc. is a holding company and operates through its subsidiaries including its management company, RCI Management Services, Inc. All services and management operations are conducted by subsidiaries of RCI Hospitality Holdings, Inc. In the context of club and bar/restaurant operations, the terms the “Company,” “we,” “our,” “us” and similar terms used in this Form 10-Q refer to subsidiaries of RCI Hospitality Holdings, Inc. Excepting executive officers of RCI Hospitality Holdings, Inc., any employment referenced in this document is not with RCI Hospitality Holdings, Inc. but solely with one of its subsidiaries.

**SCHEDULE OF UNITS**

Name of Establishment	Date Acquired/Opened
Club Onyx, Houston, TX	1995
Rick’s Cabaret, Minneapolis, MN	1998
XTC Cabaret, Austin, TX	1998
XTC Cabaret, San Antonio, TX	1998
XTC Cabaret, Houston, TX	2004
Rick’s Cabaret, New York City, NY	2005
Club Onyx, Charlotte, NC	2005
Rick’s Cabaret, San Antonio, TX	2006
XTC Cabaret, South Houston, TX	2006
Rick’s Cabaret, Fort Worth, TX	2007
Tootsie's Cabaret, Miami Gardens, FL	2008
XTC Cabaret, Dallas, TX	2008
Club Onyx, Dallas, TX	2008
Club Onyx, Philadelphia, PA	2008
Rick’s Cabaret, Round Rock, TX	2009

Edgar Filing: RCI HOSPITALITY HOLDINGS, INC. - Form 10-Q

Cabaret North, Fort Worth, TX	2009
Cabaret East, Fort Worth, TX	2010
Rick's Cabaret DFW, Fort Worth, TX	2011
Downtown Cabaret, Minneapolis, MN	2011
Rick's Cabaret, Indianapolis, IN	2011
Temptations, Aledo, TX	2011
Silver City Cabaret, Dallas, TX	2012
Jaguars Club, Odessa, TX	2012
Jaguars Club, Phoenix, AZ	2012
Jaguars Club, Lubbock, TX	2012
Jaguars Club, Longview, TX	2012
Jaguars Club, Tye, TX	2012
Jaguars Club, Edinburg, TX	2012
Jaguars Club, El Paso, TX	2012
Jaguars Club, Harlingen, TX	2012
Jaguar's Club, Beaumont, TX	2012
Vee Lounge, Fort Worth, TX	2013
Bombshells, Dallas, TX	2013
Temptations, Sulphur, LA	2013
Temptations, Beaumont, TX	2013
Bombshells, Webster, TX	2013
The Black Orchid, Dallas, TX	2013
Vivid Cabaret, New York, NY	2014
Bombshells, Austin, TX	2014
Rick's Cabaret, Odessa, TX	2014
Bombshells, Spring TX	2014
Bombshells, Houston, TX	2014
Down in Texas Saloon, Austin TX	2015
The Seville, Minneapolis MN	2015

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

## **CRITICAL ACCOUNTING POLICIES**

Management's discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles of the United States of America ("GAAP"). GAAP consists of a set of standards issued by the FASB and other authoritative bodies in the form of FASB Statements, Interpretations, FASB Staff Positions, Emerging Issues Task Force consensuses and American Institute of Certified Public Accountants Statements of Position, among others. The Company has updated references to GAAP in this Form 10-Q to reflect the guidance in the ASC. The preparation of these consolidated financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On a regular basis, we evaluate these estimates, including investment impairment. These estimates are based on management's historical industry experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

### Property and Equipment

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

### Goodwill and Intangible Assets

GAAP addresses the accounting for goodwill and other intangible assets. Goodwill and intangible assets with indefinite lives are no longer amortized, but reviewed on an annual basis for impairment. Definite lived intangible assets are amortized on a straight-line basis over their estimated lives. Fully amortized assets are written-off against

accumulated amortization.

### Impairment of Long-Lived Assets

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

Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired in accordance with GAAP. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value.

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

### Fair Value of Financial Instruments

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

### Revenue Recognition

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





The Company recognizes Internet revenue from monthly subscriptions to its online entertainment sites when notification of a new or existing subscription and its related fee are received from the third party hosting company or from the credit card company, usually two to three days after the transaction has occurred. The monthly fee is not refundable. The Company recognizes Internet auction revenue when payment is received from the credit card as revenues are not deemed estimable nor collection deemed probable prior to that point.

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

### Income Taxes

Deferred income taxes are determined using the liability method in accordance with GAAP. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In addition, a valuation allowance is established to reduce any deferred tax asset for which it is determined that it is more likely than not that some portion of the deferred tax asset will not be realized.

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

### Stock-Based Compensation

The compensation cost recognized for the nine months ended June 30, 2015 and 2014 was \$360,036 (from restricted stock) and \$156,449 (from options), respectively. There were 10,000 and 100,000 stock options exercised during the nine months ended June 30, 2015 and 2014, aggregating \$87,000 and \$843,600, respectively.

**RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2015 AS COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2014**

For the three months ended June 30, 2015, we had consolidated total revenues of \$35.8 million compared to consolidated total revenues of \$33.3 million for the three months ended June 30, 2014, an increase of \$2.5 million or 7.3%. The increase in total revenues was primarily attributable to clubs acquired during the last year with a 5.3% decrease in same-store sales. Total revenues for same location same period decreased to \$30.2 million in 2015 from \$31.9 million in 2014.

Following is a comparison of the Company's income statement for the quarters ended June 30, 2015 and 2014 with percentages compared to total revenue:

(in thousands)	2015	%	2014	%
Sales of alcoholic beverages	\$15,148	42.4 %	\$13,626	40.9 %
Sales of food and merchandise	5,049	14.1 %	4,076	12.2 %
Service Revenues	13,870	38.8 %	14,035	42.1 %
Other	1,694	4.7 %	1,606	4.8 %
Total Revenues	35,761	100.0%	33,343	100.0%
Cost of Goods Sold	5,033	14.1 %	4,295	12.9 %
Salaries & Wages	8,176	22.9 %	7,219	21.7 %
Stock-based Compensation	120	0.3 %	2	0.0 %
Taxes and permits	5,444	15.2 %	5,150	15.4 %
Charge card fees	562	1.6 %	479	1.4 %
Rent	1,189	3.3 %	1,315	3.9 %
Legal & professional	939	2.6 %	1,206	3.6 %
Advertising and marketing	1,506	4.2 %	1,420	4.3 %
Insurance	866	2.4 %	1,014	3.0 %
Utilities	727	2.0 %	650	1.9 %
Depreciation and amortization	1,923	5.4 %	1,532	4.6 %
Gain on sale of property	178	0.5 %	334	1.0 %
Settlement of lawsuits and other one-time costs	10	0.0 %	3,233	9.8 %
Gain on settlement of patron tax issue	(8,167 )	-22.8 %	-	0.0 %
Other	3,103	8.7 %	2,602	7.8 %
Total operating expenses	21,609	60.4 %	30,451	91.3 %
Operating income	14,152	39.6 %	2,557	8.7 %
Interest income	-	0.0 %	-	0.0 %
Interest expense	(1,630 )	-4.6 %	(2,060 )	-6.2 %
Gain from original investment in Drink Robust	-	0.0 %	-	0.0 %
Income before income taxes	\$12,522	35.0 %	\$832	2.5 %

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

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

Cost of goods sold includes cost of alcoholic and non-alcoholic beverages, food, cigars and cigarettes, merchandise, media printing/binding and media postage. The cost of goods sold percentage increase is due to the increase in revenues of the restaurant/bar segment which has higher cost of goods sold than the nightclub segment. The cost of goods sold for the club operations was 11.9% for each of the three months ended June 30, 2015 and 2014. The cost of goods sold for same-location-same-period of club operations for the three months ended June 30, 2015 was 12.6%, compared to 12.3% for the same period ended June 30, 2014.

Payroll for same-location-same-period of club operations was \$5.7 million for each of the three months ended June 30, 2015 and 2014. Management currently believes that its labor and management staff levels are appropriate.

The decrease in the percentage of rent expense to revenues is principally due to the sale/closure of certain clubs in the last year.

The decrease in legal and professional expense is principally due to the settlement in the second quarter of the labor lawsuit in New York which was more active in the 2014 quarter. Also see Note 11 of Notes to Consolidated Financial Statements for more information regarding our former general liability insurer.

The decrease in insurance expense is principally due to a general liability insurance premium decrease in the current fiscal year compared to the prior year. Also see Note 11 of Notes to Consolidated Financial Statements for more information regarding our former general liability insurer.

The increase in depreciation and amortization is due to an increase in assets due to acquisitions and new restaurant openings and also due to the amortization of the definite lived intangibles acquired in the Drink Robust acquisition.

Settlement of lawsuits and other one-time costs in 2014 include a \$2 million settlement with a claimant which was unpaid by our general liability insurance carrier. We will be filing a claim with the insurance company's estate and with the state's insurance fund for this settlement. Also included is \$775,000 to settle a previously-disclosed claim by the state of Nevada for \$2.1 million in Live Entertainment Tax. The Company does not believe it was subject to the Live Entertainment Tax, but to avoid further litigation, agreed to settle this contingency during June 2014. This amount has been expensed and paid in June 2014.

See Note 11 of Notes to Consolidated Financial Statements for an explanation of the gain on settlement of patron tax issue.

Income taxes, as a percentage of income before taxes was 35.5% and 24.4% for the quarters ended June 30, 2015 and 2014, respectively. The small percentage in 2014 is principally due to the tax deductions from exercised stock options.

Operating income (exclusive of corporate overhead) for same-location-same-period unit operations was \$15.0 million for the quarter ended June 30, 2015 compared to \$7.3 million for the quarter ended June 30, 2014. The 2015 period was favorably affected by \$8.2 million in gain on settlement of patron tax issue.

Our "operating margin", the percentage of operating income to total revenues, was 39.6% and 8.7% for the quarters ended June 30, 2015 and 2014, respectively. See non-GAAP financial measures for further analysis of our operating income.

**RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED JUNE 30, 2015 AS COMPARED TO THE NINE MONTHS ENDED JUNE 30, 2014**

For the nine months ended June 30, 2015, we had consolidated total revenues of \$109.7 million compared to consolidated total revenues of \$95.6 million for the nine months ended June 30, 2014, an increase of \$14.1 million or 14.7%. Total revenues for same location same period increased to \$84.3 million in 2015 from \$83.8 million in 2014.

Following is a comparison of the Company's income statement for the nine months ended June 30, 2015 and 2014 with percentages compared to total revenue:

(in thousands)	2015	%	2014	%
Sales of alcoholic beverages	\$45,963	41.9 %	\$38,300	40.0 %
Sales of food and merchandise	15,515	14.1 %	11,478	12.0 %
Service Revenues	42,623	38.9 %	41,112	43.0 %
Other	5,557	5.0 %	4,746	5.0 %
Total Revenues	109,658	100.0 %	95,636	100.0 %
Cost of Goods Sold	15,525	14.2 %	12,083	12.6 %
Salaries & Wages	24,323	22.2 %	20,650	21.6 %
Stock-based Compensation	360	0.3 %	156	0.2 %
Taxes and permits	16,546	15.1 %	14,707	15.4 %
Charge card fees	1,653	1.5 %	1,356	1.4 %
Rent	3,514	3.2 %	3,699	3.9 %
Legal & professional	2,962	2.7 %	2,420	2.5 %
Advertising and marketing	4,185	3.8 %	4,111	4.3 %
Insurance	2,487	2.3 %	2,785	2.9 %
Utilities	2,169	2.0 %	1,891	2.0 %
Depreciation and amortization	5,454	5.0 %	4,438	4.6 %
Gain on sale of property	160	0.1 %	248	0.3 %
Impairment of assets	1,358	1.2 %		0.0 %
Settlement of lawsuits and other one-time costs	10,560	9.6 %	3,503	3.7 %
Gain on settlement of patron tax issue	(8,167 )	-7.4 %		0.0 %
Other	8,893	8.1 %	7,624	8.0 %
Total operating expenses	91,982	83.9 %	79,671	83.3 %
Operating income	17,676	16.1 %	15,965	16.7 %
Interest income	39	0.0 %	112	0.1 %
Interest expense	(5,032 )	-4.6 %	(5,996 )	-6.3 %
Gain from original investment in Drink Robust	577	0.5 %	-	0.0 %
Income before income taxes	\$13,260	12.1 %	\$10,081	10.5 %

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

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

Cost of goods sold includes cost of alcoholic and non-alcoholic beverages, food, cigars and cigarettes, merchandise, media printing/binding, media postage and internet traffic purchases and webmaster payouts. The cost of goods sold percentage increase is due to the increase in revenues of the restaurant/bar segment which has higher cost of goods sold than the nightclub segment. The cost of goods sold for the club operations for the nine months ended June 30, 2015 was 11.9% for each of the nine months ended June 30, 2015 and 2014. The cost of goods sold for same-location-same-period of all unit operations for the nine months ended June 30, 2015 was 12.4%, compared to 12.1% for the same period ended June 30, 2014.

Payroll for same-location-same-period of club operations was \$15.0 million for the nine months ended June 30, 2015 and \$14.5 million for the same period in 2014. Management currently believes that its labor and management staff levels are appropriate.

The decrease in the percentage of rent expense to revenues is principally due to the sale/closure of certain clubs in the last year.

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



The decrease in insurance expense is principally due to a general liability insurance premium decrease in the current fiscal year compared to the prior year. Also see Note 11 of Notes to Consolidated Financial Statements for more information regarding our former general liability insurer.

The increase in depreciation and amortization is due to an increase in assets due to acquisitions and new restaurant openings and also due to the amortization of the definite lived intangibles acquired in the Drink Robust acquisition.

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

See Note 11 of Notes to Consolidated Financial Statements for an explanation of the settlement of a lawsuit in 2015.

See Note 11 of Notes to Consolidated Financial Statements for an explanation of the gain on settlement of patron tax issue.

Income taxes, as a percentage of income before taxes was 37.9% and 34.2% for the nine months ended June 30, 2015 and 2014, respectively. The lower rate in 2014 is principally due to the tax deductions from exercised stock options in 2014.

Operating income (exclusive of corporate overhead) for same-location-same-period of all units operations decreased to \$19.2 million for the nine months ended June 30, 2015 from to \$21.2 million for same period ended June 30, 2014, or by 10.0%. See non-GAAP financial measures for further analysis of our operating income.

Our “operating margin”, the percentage of operating income to total revenues, was 16.1% and 16.7% for the nine months ended June 30, 2015 and 2014, respectively. See non-GAAP financial measures for further analysis of our operating income.

## **SEGMENT INFORMATION**

Edgar Filing: RCI HOSPITALITY HOLDINGS, INC. - Form 10-Q

The Company is engaged in adult nightclubs and Bombshells Restaurants and Bars. The Company has identified such segments based on management responsibility and the nature of the Company's products, services and costs. There are no major distinctions in geographical areas served as all operations are in the United States. The Company measures segment profit (loss) as income (loss) from operations.

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
Business segment sales:				
Night clubs	\$ 30,568	\$ 31,486	\$ 93,564	\$ 91,037
Bombshells	4,789	1,585	14,510	3,668
Other	404	272	1,584	931
	\$ 35,761	\$ 33,343	\$ 109,658	\$ 95,636
Business segment operating income:				
Night clubs	\$ 17,271	\$ 8,526	\$ 26,000	\$ 25,947
Bombshells	369	(170 )	1,480	(268 )
Other	(682 )	(220 )	(1,995 )	(521 )
General corporate	(2,806 )	(5,244 )	(7,809 )	(9,193 )
	\$ 14,152	\$ 2,892	\$ 17,676	\$ 15,965
Business segment capital expenditures:				
Night clubs	\$ 207	\$ 1,744	\$ 882	\$ 6,109
Bombshells	300	1,827	1,853	4,979
Other	529	3	973	3
General Corporate	62	50	259	731
	\$ 1,098	\$ 3,624	\$ 3,967	\$ 11,822
Business segment depreciation and amortization:				
Night clubs	\$ 823	\$ 1,297	\$ 3,731	\$ 3,802
Bombshells	229	62	502	115
Other	733	4	813	54
General corporate	138	169	408	467
	\$ 1,923	\$ 1,532	\$ 5,454	\$ 4,438

We had only one Bombshells open as of December 31, 2013. As of June 30, 2015, we had five Bombshells. Therefore, the Bombshells brand was immature as of June 30, 2014 and was beginning to mature into a profitable segment by June 30, 2015.

Nightclubs operating income above is reduced by \$10.3 million settlement of lawsuits and one-time costs for the nine months ended June 30, 2015.

## **Non-GAAP Financial Measures**

In addition to our financial information presented in accordance with GAAP, management uses certain “non-GAAP financial measures” within the meaning of the SEC Regulation G, to clarify and enhance understanding of past performance and prospects for the future. Generally, a non-GAAP financial measure is a numerical measure of a company’s operating performance, financial position or cash flows that excludes or includes amounts that are included in or excluded from the most directly comparable measure calculated and presented in accordance with GAAP. We monitor non-GAAP financial measures because it describes the operating performance of the company and helps management and investors gauge our ability to generate cash flow, excluding some recurring charges that are included in the most directly comparable measures calculated and presented in accordance with GAAP. Relative to each of the non-GAAP financial measures, we further set forth our rationale as follows:

*Non-GAAP Operating Income and Non-GAAP Operating Margin.* We exclude from non-GAAP operating income and non-GAAP operating margin amortization of intangibles, gain on settlement of patron tax case, pre-opening costs, gains and losses from asset sales, stock-based compensation charges, litigation and other one-time legal settlements and acquisition costs. We believe that excluding these items assists investors in evaluating period-over-period changes in our operating income and operating margin without the impact of items that are not a result of our day-to-day business and operations. While we were in litigation in the patron tax case, we also included patron taxes as an exclusion, but after settlement of the case, we no longer exclude patron taxes from operating income.

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

*Adjusted EBITDA .* We exclude from Adjusted EBITDA depreciation expense, amortization of intangibles, income tax, interest expense, interest income, gains and losses from asset sales, acquisition costs, litigation and other one-time legal settlements, gain on settlement of patron tax case and impairment charges because we believe that adjusting for such items helps management and investors better understand operating activities. Adjusted EBITDA provides a core operational performance measurement that compares results without the need to adjust for Federal, state and local

taxes which have considerable variation between domestic jurisdictions. Also, we exclude interest cost in our calculation of Adjusted EBITDA. The results are, therefore, without consideration of financing alternatives of capital employed. We use Adjusted EBITDA as one guideline to assess our unleveraged performance return on our investments. Adjusted EBITDA is also the target benchmark for our acquisitions of nightclubs.

The following tables present our non-GAAP measures for the periods ended June 30, 2015 and 2014 (in thousands, except per share amounts):

(in thousands)	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
	2015	2014	2015	2014
<b>Reconciliation of GAAP net income to Adjusted EBITDA</b>				
GAAP net income attributable to RCIHH	\$ 8,267	\$ 691	\$ 8,786	\$ 6,816
Income tax expense	4,442	203	5,023	3,448
Interest expense and income	1,630	2,060	4,993	5,884
Litigation and other one-time legal settlements	10	3,233	10,560	3,503
Gain on settlement of Patron tax case	(8,167 )	-	(8,167 )	-
Impairment of assets	-	-	1,358	-
Acquisition costs	105	22	283	111
Depreciation and amortization	1,923	1,532	5,454	4,438
Adjusted EBITDA	\$ 8,210	\$ 7,741	\$ 28,290	\$ 24,200
<b>Reconciliation of GAAP net income to non-GAAP net income</b>				
GAAP net income attributable to RCIHH	\$ 8,267	\$ 691	\$ 8,786	\$ 6,816
Amortization of intangibles	312	82	892	254
Stock-based compensation	120	2	360	156
Litigation and other one-time settlements	10	3,233	10,560	3,503
Gain on settlement of Patron tax case	(8,167 )	-	(8,167 )	-
Pre-opening costs	-	306	328	743
Income tax expense	4,442	203	5,023	3,448
Impairment of assets	-	-	1,358	-
Acquisition costs	105	22	283	111
Non-GAAP provision for income taxes	(1,739 )	(1,588 )	(6,672 )	(5,206 )
Non-GAAP net income	\$ 3,350	\$ 2,951	\$ 12,751	\$ 9,825
<b>Reconciliation of GAAP diluted net income per share to non-GAAP diluted net income per share</b>				
Fully diluted shares	10,707	9,968	10,724	9,922
GAAP net income attributable to RCIHH	\$ 0.78	\$ 0.07	\$ 0.85	\$ 0.69
Amortization of intangibles	0.03	0.01	0.08	0.03
Stock-based compensation	0.01	0.00	0.03	0.02
Litigation and other one-time settlements	0.00	0.32	0.99	0.35
Gain on settlement of Patron tax case	(0.76 )	-	(0.76 )	-
Pre-opening costs	-	0.03	0.03	0.07
Impairment of assets	-	-	0.13	-
Income tax expense	0.41	0.02	0.47	0.35
Acquisition costs	0.01	0.00	0.03	0.01
Non-GAAP provision for income taxes	(0.16 )	(0.16 )	(0.62 )	(0.52 )
Non-GAAP diluted net income per share	\$ 0.32	\$ 0.30	\$ 1.22	\$ 0.99

**Reconciliation of GAAP operating income to non-GAAP operating income**

GAAP operating income	\$ 14,152	\$ 2,892	\$ 17,676	\$ 15,965
Amortization of intangibles	312	82	892	254
Stock-based compensation	120	2	360	156
Litigation and other one-time settlements	10	3,233	10,560	3,503
Gain on settlement of Patron tax case	(8,167 )	-	(8,167 )	-
Impairment of assets	-	-	1,358	-
Pre-opening costs	-	306	328	743
Acquisition costs	105	22	283	111
Non-GAAP operating income	\$ 6,532	\$ 6,537	\$ 23,290	\$ 20,732

**Reconciliation of GAAP operating margin to non-GAAP operating margin**

GAAP operating income	39.6	%	8.7	%	16.1	%	16.7	%
Amortization of intangibles	0.9	%	0.2	%	0.8	%	0.3	%
Stock-based compensation	0.3	%	0.0	%	0.3	%	0.2	%
Litigation and other one-time settlements	0.0	%	9.7	%	9.6	%	3.7	%
Gain on settlement of Patron tax case	-22.8	%	0.0	%	-7.4	%	0.0	%
Impairment of assets	0.0	%	0.0	%	1.2	%	0.0	%
Pre-opening costs	0.0	%	0.9	%	0.3	%	0.8	%
Acquisition costs	0.3	%	0.1	%	0.3	%	0.1	%
Non-GAAP operating margin	18.3	%	19.6	%	21.2	%	21.7	%

## LIQUIDITY AND CAPITAL RESOURCES

We believe our ability to generate cash from operating activities is one of our fundamental financial strengths. Refer to the heading "Cash Flows from Operating Activities" below. The near-term outlook for our business remains strong, and we expect to generate substantial cash flows from operations in 2015. As a result of our expected cash flows from operations, we have significant flexibility to meet our financial commitments. The Company has not recently raised capital through the issuance of equity securities. Instead, we use debt financing to lower our overall cost of capital and increase our return on shareowners' equity. Refer to the heading "Cash Flows from Financing Activities" below. We have a history of borrowing funds in private transactions, from sellers in acquisition transactions and recently from banks, and continue to have the ability to borrow funds at reasonable interest rates in that manner. We have historically utilized these cash flows to invest in property and equipment, adult nightclubs and restaurant/bars. Refer to the heading "Cash Flows from Investing Activities" below.

As of June 30, 2015, we had a working capital deficit of \$1.7 million compared to working capital deficit of \$15.8 million as of September 30, 2014. The decrease in deficit is principally due the following items:

Decrease in liabilities due to the settlement of the patron tax issue and reclassification of a portion of the settlement to long-term debt.

Net cash flow for the nine months.

Increase in liabilities due to the settlement of the New York lawsuit.

Some of the current portion of debt is convertible debt and it is anticipated that it will be redeemed with common shares. Because of the large volume of cash we handle, stringent cash controls have been implemented. At June 30, 2015, our cash and cash equivalents were \$14.7 million compared to \$10.0 million at September 30, 2014. We have been reserving excess cash flow for several months to utilize in the acquisition of the real estate for our Miami Gardens location and to pay the New York wage and hour litigation settlement. We have the ability to borrow necessary funds, if needed, for these.

Our depreciation for the quarter ended June 30, 2015 was \$1.6 million compared to \$1.5 million for the quarter ended June 30, 2014. Our amortization for the quarter ended June 30, 2015 was \$312,000 compared to \$82,000 for the quarter ended June 30, 2014.

### *Sources and Use of Funds*

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

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



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

### Cash Flows from Operating Activities

Following are our summarized cash flows from operating activities:

(in thousands)	Nine Months Ended June 30,	
	2015	2014
Net income	\$ 8,237	\$ 6,633
Depreciation and amortization	5,454	4,438
Deferred taxes	3,459	225
Stock compensation expense	360	156
Loss on sale of assets and impairment of assets	1,518	248
Gain on settlement of patron tax	(8,167 )	-
Gain from original investment in Drink Robust	(577 )	-
Change in operating assets and liabilities	7,965	2,050
Other	31	48
	\$ 18,280	\$ 13,798

### Cash Flows from Investing Activities

Following are our summarized cash flows from investing activities:

(in thousands)	Nine Months Ended June 30,	
	2015	2014
Proceeds from sale of marketable securities and other assets	\$ -	\$ 223
Acquisition of development rights in New York Building	-	(5,325 )
Additions to property and equipment	(3,967 )	(11,822 )
Additions of businesses, net of cash acquired	(2,217 )	(500 )
	\$ (6,184 )	\$ (17,424 )

Following is a reconciliation of our additions to property and equipment for the nine months ended June 30, 2015 and 2014:

Edgar Filing: RCI HOSPITALITY HOLDINGS, INC. - Form 10-Q

(in thousands)	Nine Months Ended June 30,	
	2015	2014
Acquisition of real estate	\$ 8,370	\$ 3,103
Capital expenditures funded by debt	(7,977 )	(4,879 )
New capital expenditure in new clubs and purchase of aircraft	2,283	12,188
Maintenance capital expenditures	1,291	1,410
Total capital expenditures in consolidated statement of cash flows	\$ 3,967	\$ 11,822

**Cash Flows from Financing Activities**

Following are our summarized cash flows from financing activities:

(in thousands)	Nine Months Ended June 30,	
	2015	2014
Proceeds from long-term debt	\$ 4,957	\$ 7,025
Payments on long-term debt	(9,916 )	(5,899 )
Purchase of treasury stock	(2,296 )	-
Exercise of stock options	87	3,126
Distribution of minority interests	(162 )	(162 )
	\$ (7,330 )	\$ 4,090

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

(in thousands)	Nine Months Ended June 30,	
	2015	2014
Operating activities	\$ 18,280	\$ 13,798
Investing activities	(6,184 )	(17,424 )
Financing activities	(7,330 )	4,090
Net increase in cash	\$ 4,766	\$ 464

We are not aware of any event or trend that would potentially affect liquidity. In the event such a trend develops, we believe our working capital and capital expenditure requirements will be adequately met by cash flows from operations. In our opinion, working capital is not a true indicator of our financial status. Typically, businesses in our industry carry current liabilities in excess of current assets because businesses in our industry receive substantially immediate payment for sales, with nominal receivables, while inventories and other current liabilities normally carry longer payment terms. Vendors and purveyors often remain flexible with payment terms, providing businesses in our industry with opportunities to adjust to short-term business down turns. We consider the primary indicators of financial status to be the long-term trend of revenue growth, the mix of sales revenues, overall cash flow, profitability from operations and the level of long-term debt.

The following table presents a summary of such indicators for the nine months ended June 30:

(in thousands)	2015	Increase	
		(Decrease)	2014
Sales of alcoholic beverages	\$45,963	20.0	% \$38,300
Sales of food and merchandise	15,515	35.2	% 11,478
Service Revenues	42,623	3.7	% 41,112
Other	5,557	16.5	% 4,746
Total Revenues	\$109,658	14.7	% \$95,636
Net cash provided by operating activities	18,280	32.5	% 13,798
Adjusted EBITDA*	28,290	16.9	% 24,200
Long-term debt	84,361	2.4	% 82,383

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

### Share repurchase

On September 29, 2008, our Board of Directors authorized us to repurchase up to \$5 million worth of our common stock in the open market. As of April 2013, we completed the repurchase of all \$5 million in stock authorized under this plan. On April 25, 2013, our Board of Directors authorized us to repurchase up to an additional \$3 million worth of our common stock in the open market or in privately negotiated transactions. During May 2014, our Board of Directors increased the repurchase authorization to \$10 million. During the quarter ended June 30, 2015, we purchased 32,853 shares of common stock in the open market for an aggregate cost of \$370,799. Under the Board's authority, we have \$6.6 million remaining to purchase additional shares as of June 30, 2015.

### Other Liquidity and Capital Resources

We have not established lines of credit or financing other than the notes payable and our existing debt. There can be no assurance that we will be able to obtain additional financing on reasonable terms in the future, if at all, should the need arise.

We believe that the adult entertainment industry standard of treating entertainers as independent contractors provides us with safe harbor protection to preclude payroll tax assessment for prior years. We have prepared plans that we believe will protect our profitability in the event that sexually oriented business industry is required in all states to convert dancers who are now independent contractors into employees.

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

### **IMPACT OF INFLATION**

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

**SEASONALITY**

Our nightclub operations are affected by seasonal factors. Historically, we have experienced reduced revenues from April through September with the strongest operating results occurring during October through March.

## GROWTH STRATEGY

We believe that our nightclub operations can continue to grow organically and through careful entry into markets and demographic segments with high growth potential. Our growth strategy is: (a) to open new clubs after market analysis, (b) to acquire existing clubs in locations that are consistent with our growth and income targets and which appear receptive to the upscale club formula we have developed, (c) to form joint ventures or partnerships to reduce start-up and operating costs, with us contributing equity in the form of our brand name and management expertise, (d) to develop new club concepts that are consistent with our management and marketing skills, (e) to develop and open our restaurant concepts as our capital and manpower allow, and/or (f) to control the real estate in connection with club operations, although some clubs may be in leased premises.

During fiscal 2013, in addition to the real estate explained in the previous paragraph, we have acquired an existing licensed location for \$3,000,000 (\$1.5 million in cash and the balance in promissory notes). This location was remodeled and opened in January 2014. We also acquired the remaining 50% of an unopened club for \$863,000 of common stock in May 2013. We also acquired another club for \$300,000 in cash. We previously had acquired the real estate for this location.

In October 2013, the Company purchased 49 percent of a corporation that operates the Dallas club “PT’s Platinum” and also acquired the building and personal property. Total cost of the transaction was \$500,000. During fiscal 2013, in addition to the real estate explained in the previous paragraph, we have acquired an existing licensed location for \$3,000,000 (\$1.5 million in cash and the balance in promissory notes). This location was being remodeled and opened in 2013. We also acquired the remaining 50% of an unopened club for \$863,000 of common stock in May 2013. We also acquired another club for \$300,000 in cash. We previously had acquired the real estate for this location. We also opened two bar/restaurants in 2013.

During fiscal 2014, we acquired 49% of an adult club, including the building in which it operates, for \$500,000. We also opened two more bar/restaurants in fiscal 2014 and opened another in November 2014.

On October 30, 2014, a 51% owned subsidiary of the Company (“Robust”) acquired certain assets and liabilities of Robust Energy LLC for \$200,000 in cash and 200,000 shares of its common stock for a total purchase price of \$5.0 million. The Company has also agreed to issue 50,000 shares of RCIHH common stock to the two principals of Robust Energy LLC if Robust has net income of at least \$1 million during the 2015 calendar year. Robust is an energy drink distributor, targeting the on premises bar and mixer market.

On January 13, 2015 a Company subsidiary purchased Down in Texas Saloon gentlemen’s club in an Austin, Texas suburb. As part of the transaction, another subsidiary also purchased the club’s real estate. Total consideration of \$6.8

million consisted of \$3.5 million for the club business and \$3.3 million for its 3.5 acres of real estate. Payment was in the form of \$1 million in cash and \$1.4 million in seller financing at 6% annual interest, with the balance provided by commercial bank financing at a variable interest rate equal to the prime rate plus 2%, but in no event less than 6.5%.

On May 4, 2015 a Company subsidiary purchased The Seville gentlemen's club in Minneapolis Minnesota. As part of the transaction, another subsidiary also purchased the club's real estate. Total consideration of \$8.5 million consisted of \$4.5 million for the assets of the club business and \$4.0 million for the real estate. Payment was made through bank financing of \$5.7 million at 5.5% interest, seller financing of \$1.8 million at 6% and cash of \$1.1 million.

Principally during 2014 and 2015, we have opened five Bombshells. We are considering other locations to add to our Bombshells division.

We continue to evaluate opportunities to acquire new nightclubs and anticipate acquiring new locations that fit our business model as we have done in the past. The acquisition of additional clubs will require us to obtain additional debt or issuance of our common stock, or both. There can be no assurance that we will be able to obtain additional financing on reasonable terms in the future, if at all, should the need arise. An inability to obtain such additional financing could have an adverse effect on our growth strategy.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

As of June 30, 2015, 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, 2014.

#### **Item 4. Controls and Procedures.**

##### *Evaluation of Disclosure Controls and Procedures*

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

##### *Changes in Internal Control Over Financial Reporting*

There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2015 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## **PART II—OTHER INFORMATION**

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

See "Legal Matters" under Note 11 of Notes to Consolidated Financial Statements above, which information is incorporated herein by reference.

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



In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended September 30, 2014, as such factors could materially affect the Company's business, financial condition or future results. In the three months ended June 30, 2015, there were no material changes to the risk factors disclosed in the Company's 2014 Annual Report on Form 10-K. The risks described in the Annual Report on Form 10-K are not the only risks the Company faces. Additional risks and uncertainties not currently known to the Company, or that the Company deems to be immaterial, also may have a material adverse impact on the Company's business, financial condition or results of operations.

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

On September 29, 2008, our Board of Directors authorized us to repurchase up to \$5 million worth of our common stock in the open market. As of April 2013, we completed the repurchase of all \$5 million in stock authorized under this plan. On April 25, 2013, our Board of Directors authorized us to repurchase up to an additional \$3 million worth of our common stock in the open market or in privately negotiated transactions. During May 2014, our Board of Directors increased the repurchase authorization to \$10 million. During the quarter ended June 30, 2015, we purchased 32,853 shares of common stock in the open market for an aggregate cost of \$370,799. Under the Board's authority, we have \$6.6 million remaining to purchase additional shares as of June 30, 2015.

Following is a summary of our purchases by month:

(in thousands, except per share data)

Period:	(a)	(b)	(c)	(d)
	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (2)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs(1)	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet be Purchased Under the Plans or Programs
Month Ending				
Apr-15	24	\$ 11.08	24	\$ 6,660
May-15	9	\$ 11.82	9	\$ 6,553
Jun-15	-	\$ -	-	\$ 6,553
Total for the three months ended June 30, 2015	33	11.29	33	6,553

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

(2) Prices include any commissions and transaction costs.

31

**Item 6. Exhibits.**

Exhibit 31.1 – Certification of Chief Executive Officer of RCI Hospitality Holdings, Inc. required by Rule 13a – 14(1) or Rule 15d – 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 31.2 – Certification of Chief Financial Officer of RCI Hospitality Holdings, Inc. required by Rule 13a – 14(1) or Rule 15d – 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.1 – Certification of Chief Executive Officer and Chief Financial Officer of RCI Hospitality Holdings, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and Section 1350 of 18 U.S.C. 63.

101.INS XBRL Instance Document.

101.SCH XBRL Taxonomy Schema.

101.CAL XBRL Taxonomy Extension Calculation Linkbase.

101.DEF XBRL Taxonomy Extension Definition Linkbase.

101.LAB XBRL Taxonomy Extension Label Linkbase.

101.PRE XBRL Taxonomy Extension Presentation Linkbase.

**SIGNATURES**

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

**RCI HOSPITALITY  
HOLDINGS, INC.**

Date: August 10, 2015 By: /s/ Eric S. Langan  
Eric S. Langan  
Chief Executive  
Officer and President

Date: August 10, 2015 By: /s/ Phillip K. Marshall  
Phillip K. Marshall  
Chief Financial Officer  
and Principal Accounting  
Officer