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Transcript of
RCI Hospitality Holdings
First Quarter 2020 Earnings Call and Webcast
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Participants

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Eric Scott Langan – CEO and President
Phillip Marshall – Chief Financial Officer
Bradley Chhay – Controller

Analysts

Marco Rodriguez – Stonegate Capital Markets
Jason Scheurer – Orchard Wealth
Adam Wyden – ADW Capital
Douglas Weiss – DSW Investment
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Presentation

Operator
Greetings, and welcome to the RCI Hospitality Holdings conference call and webcast. At this time all participants are in a listen-only mode. A question and answer session will follow the formal presentation. [Operator Instructions]. As a reminder, this conference is being recorded. It is now my pleasure to introduce Gary Fishman, who handles Investor Relations for RCI.

Gary Fishman – Investor Relations
Thank you. For those of you listening to this call on the phone, you can find our presentation on the RCI website. Click "Company and Investor Information" just under the RCI logo. That will take you to the "Company and Investor info" page, scroll down a little and you'll find all the necessary links for this call. Or you could go to the webcast where you'll see our slides.

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

Please turn to Slide 3. I also direct you to the explanation of non-GAAP measurements that we use and are included in our presentation and news release.

And please turn to Slide 4. Here are comparable GAAP versions of four charts and tables we will be using in today's presentation.

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

Eric Langan – President and CEO
Thanks for joining us today. I'm here with our CFO, Phil Marshall, and our Controller, Bradley Chhay. Before we start, I'd like to thank our staff and our new auditors again. For the last two weeks, they worked long hours to get our first quarter 10-Q filed and bring us current with our filings.

Please turn to Slide 5 for today's news. After the market closed, we filed our 10-Q, as we had expected to do during late February. We reported $48.4 million in total revenues. That's up 9.9% year-over-year. GAAP EPS was $0.60 compared to $0.65. The year-ago quarter included $1.1 million in pretax net gains on the sale of excess assets. On a non-GAAP basis, EPS was $0.62 compared to $0.61.

The star of the show was our Bombshell segment. Quarterly revenues hit $10.4 million, up more than 72% year-over-year. Not only that, but the segment margin rebounded to 15.2%. Based on that and other trends I'll discuss, we expect performance to continue to grow.

Nightclubs maintained their strong contribution, despite an unusual calendar. We had one less holiday sales week during the important Thanksgiving to Christmas period. As we previously reported, performance has picked up due in part to a great second quarter sports calendar in markets where we have some of our largest clubs. Our Northeast Corridor acquisition continues on track.

Regarding our capital allocation strategy, we generated $9.3 million in free cash flow. That's in line with our current $30 million run rate. We used $6.4 million in excess cash to buy back 330,000 shares in the first quarter. That reduced weighted-average shares outstanding 4% year-over-year. And we still ended the quarter with more than $13 million in cash.

During and subsequent to the first quarter, we eliminated $10.8 million in near-term balloon debt to retain cash and increase our financial flexibility. This flexibility will be further enhanced when we close on approximately $6.7 million in excess properties under contract to sell, and when we sell or lease the remaining excess properties with approximately $9 million in market value.

After the first quarter, we also increased our buyback authorization by $10 million, giving us a total of $13.8 million available, and we increased our annual cash dividend 7.7%.

Please turn to Slide 6 to review our first quarter operating results. Nightclubs segment sales were on a similar level to last year. The first quarter of fiscal '20 included two new clubs, Rick's Cabaret in Chicago and Pittsburgh, which we acquired in November of 2018. Two clubs were closed for part of the quarter, and as I mentioned earlier, one less holiday sales week. Bombshells had a record performance. This reflected three units in the new sales count for the full quarter; Bombshells Katy, which opened in the second half of October to great numbers; and more than 19% same-store sales growth from our first five restaurants.

Nightclubs operating profit was down $1.6 million. Most of that was due to $1.2 million in gains on sale of noncore business assets in the year ago quarter. Bombshells operating profit jumped to $1.6 million from a relatively small amount in the year ago quarter. That reflects both improved revenue and margin, despite preopening costs for Bombshells Katy for several weeks, and Bombshells 59 for the full quarter. Corporate expenses were $1.2 million higher. This was primarily due to higher audit, legal, and overtime expenses related to our 10-K filing, as I had indicated they would be in our last call.

On a non-GAAP basis, operating profit was off only $375,000 from last year, which was made up for on a per share basis through our stock buybacks.

Please turn to Slide 7 to review our sales and margin trends. First quarter revenue hit a new record, largely due to Bombshells. The segment's higher contribution offset the increase in corporate expenses. Looking ahead, you can see our total operating margin should begin to improve. Bombshells segment margin is expected to continue to grow with all new units open and continued improvement in same-store sales. Nightclubs segment margin should expand with all clubs open and big sporting events near our larger clubs. I'm talking about the pro football championship in South Florida, and the pro basketball weekend in Chicago, both in February, and the college basketball tournament in New York and Houston in March. And as I've mentioned on previous calls, corporate overhead, as a percentage of revenues, should decline in the second half, with reduced auditing and related legal fees and overtime.

Please turn to Slide 8 to review our Bombshells segment. Last call we titled this slide Bombshells Turnaround Taking Shape. This call, we've retitled it, Bombshells Turnaround is Happening. All the new units continue to do very well. In the first quarter, average revenue per unit totaled approximately $1.15 million, which was up more than 30% year-over-year. That gives us increased confidence all ten locations should generate annualized sales of $40 million to $50 million. And as sales grow, margins should expand, especially with the elimination of all preopening costs as of February. Our internal target continues to be in the 18% to 21% range. As we sell or lease out the excess property around some of our newer Bombshells, we expect to generate additional increases in store traffic as those properties are developed. We haven't currently selected any new Bombshells locations. We are waiting to build up our management teams after opening six stores in such a short amount of time. We want to evaluate our ROI on our new investments.

Please turn to Slide 9 to review the Nightclubs segment. I've covered most of this already in this call, and our call two weeks ago, but I'll be happy to answer any questions you may have during the Q&A.

If you'll please turn to Slide 10 to review our cash generation. I've also discussed most of what's on this slide. The key thing I'd like to point out is that maintenance capital expenditures were significantly higher this quarter versus a year ago. This can have a noticeable effect on free cash flow. The reason why is that we stepped up our spending at our South Florida clubs in anticipation of the pro football championship this quarter, as I mentioned in the last call. We also remodeled and expanded our Bombshells in Dallas. We expect these investments to have significant payoffs.

Please turn to Slide 11 to review our capital allocation strategy. We don't have any updates on this slide from two weeks ago. We'd just like to reiterate that based on where we are today, we would continue to be comfortable buying back shares, up to $32 per share.

Please turn to Slide 12 to review the progress we have achieved with our capital allocation strategy since we started it going in fiscal '16. Revenues have grown about 34%, based on a 7% increase in units, and a 25% increase in average revenue per unit. That reflects our strategy of weeding out poor performing locations, organically growing better locations, and acquiring or building, in the case of Bombshells, larger revenue generating locations. With this base of business, we have generated a 124% increase in free cash flow. As we've shown on a previous slide, this reflects our ability to convert revenue dollars into more free cash flow dollars. At the same time, we have reduced common shares outstanding close to 7%. In total, over the last five years, we have spent $13.6 million to acquire 1.2 million shares, for an average price of about $11.43 per share.

Please turn to Slide 13 to review our long-term debt. Long-term debt net of loan cost fell $1.7 million from September 30th, and $11.3 million from a year ago. That reflects scheduled debt amortization, debt pay-down as a result of certain asset sales, and new debt associated with the development of our new Bombshells. We added a notation on this slide regarding our operating lease liabilities. In line with the new accounting standard, they totaled $28.3 million as of December 31st. These are liabilities, not debt, as I had referred to them on our last call.

Please turn to Slide 14 for a look at our debt manageability, which continues to look good. As I mentioned earlier, during and subsequent to the first quarter, we eliminated $10.8 million of near-term non-realty balloon payments. We did this to increase our financial flexibility, by eliminating any large cash needs for debt repayment. During the quarter, we moved $3 million due in May of this year to fiscal '23. That is already incorporated in the bar chart on this slide. Subsequent to the quarter, we converted two balloons totaling $7.8 million into ten-year notes. That's not reflected in our maturities bar chart yet. So, the next time you see this chart, $4 million in non-realty balloons will come out of fiscal '21, and $3.8 million in non-realty balloons will come out of fiscal '22. Looking at other debt metrics, the ratio of long-term debt to trailing 12-month adjusted EBITDA continued to fall. That's largely due to our reduced debt and stable EBITDA. Occupancy costs fell to 7.3% of revenues. That largely reflects increased revenues from Bombshells, including the Katy location, which opened during the first quarter.

To conclude, please turn to Slide 15. Going forward, our focus remains the same, running the business for maximum free cash flow. Looking at Nightclubs, our priorities are continuing to improve operations, finalize and integrating our Northeast Corridor acquisition, and ensuring that any acquisition opportunities fit our parameters. Regarding Bombshells, our priorities are guiding all our new locations to ensure their success and continue to grow same-store sales and margins at older units. In terms of asset management, we would like to close all of our pending opportunities. We continue to be focused, and we have the financial strength to grow free cash flow per share at least 10% to 15% through a combination of buying back shares, buying the right clubs in the right markets, and, of course, internal growth. Now that we have filed our 10-Q, we are up to date with our filings, and look forward to resuming our pre-fiscal '17 track record of always filing on time.

Operator, let's start with the Q&A. As always, I'm happy to talk about all aspects of the business, but I appreciate if you would understand that I'm limited in what I could say when it comes to certain legal matters.

Operator
Thank you. [Operator instructions]. Our first question comes from the line of Marco Rodriguez with Stonegate Capital Partners. Please proceed with your question.

Q: Real quick, just wanted to circle on the accounting costs, the extra costs that you guys are expecting in Q2. Can you quantify how much you're expecting to be excessive, if you will?

Eric Langan – President and CEO
I don't have the numbers yet, obviously, because we're still in the Q, but several hundred thousand dollars of the auditing fees will be paid in this quarter for the '19 audit, and a lot of it's overtime.

Q: I think you identified about a half a million in Q1 that was excessive, so maybe another 200, 300 in Q2?

Eric Langan – President and CEO
Possibly. Could be a little higher. Like I said, it's just too early. We just filed the K two weeks ago. I don't even think we've gotten all the bills in from the auditors from that period yet.

Q: Understood. And then, as it relates to Bombshells, just wondering if you might be able to help us understand and quantify some of the preopening costs associated with the ones you just opened here in the last couple quarters.

Eric Langan – President and CEO
Sure. We had to carry management. An average store has about ten managers. Our average manager goes through a training process of four to six months. So, we've been carrying, for almost a year and a half now, an excessive amount of additional managers, because we knew we were opening all those stores. So, we've had managers in training, we've had kitchen managers, and other staff. We knew the stores were opening, so we run

our staff a little higher than average. Of course, preopening, we have our training teams. When our training teams are actually opening the stores, there's a lot of additional costs in the first month that a store's open, associated with actually opening the store.

Q: Got it. Last question, kind of a difficult one here, a big unknown, the coronavirus, and a lot of the news has kind of come to the forefront here in the US, and obviously with all your locations in some pretty major cities, just wondering kind of how you guys are thinking about that. I know it's still very early days, but have you seen any sort of change in the traffic patterns at your places?

Eric Langan – President and CEO
We've seen nothing right now. Our numbers are fantastic. If anything, I guess people are going out more right now just in case they get locked for two weeks after reading about some of those cruise ship quarantines. Like I said, so far, we haven't seen any effect. Obviously, the virus isn't in any of our markets at this time. We'll monitor it, and basically follow the advice of the health officials at the time and do what we need to do.

Q: Got it. Thanks a lot, guys. Appreciate your time.

Operator
[Operator instructions]. Our next question comes from the line of Jason Scheurer with Orchard Wealth. Please proceed with your question.

Q: Quick question for you, just reiterate a little bit more, if you can, on the stock buybacks. Basically, you're saying you have $13 million available for the buybacks as of today. When can you commence doing that, and approximately how much of the average daily volume can you do?

Eric Langan – President and CEO
Well, we buy within safe harbor, or we do block transactions which exempt us, so we follow those deals. Basically, right now, we're current, so as long as we don't have any material insider information, we can purchase stock within three days from today. That's typically what the rules are for us.

Q: And then, in your free cash flow numbers that you're looking for the year, you're not including those numbers from a sale of these properties that are outstanding?

Eric Langan – President and CEO
Correct.

Q: Okay. So, if anything, we could be looking at like a $6 million surprise at some point throughout the year?

Eric Langan – President and CEO
Well, you have to remember, that's not our profit on those sales. We do have costs on those sales. But, yes, there will definitely be some upside on the sales of the assets as we move through the year.

Q: When you're looking at the Bombshells properties, do you find that actually just by putting your location there you, maybe at some point, have come up with an average to, hey, guess what, every time we buy a property the subsequent property goes up by 30% or something? Obviously, I love your idea about making sure that the businesses that you're selling to are complementary to the club itself, or the restaurant itself.

Eric Langan – President and CEO
It's varied. We've basically done three of these developments. One is completely under contract. Hopefully we close, I think we're scheduled to close in the next three weeks on the last piece of that property. We originally

bought the property for about just under $9 a foot. We put about $2 a foot into developmental costs, bringing in utilities, retention, and those types of things. So, we had just under $11 a foot into the property. After we built our store, we contracted the property. The first lot I think we sold at $16 a foot, and the second lot we have under contract at $18 a foot. Obviously, we add significant value as more places are developed and built there.

The other property we bought a considerable amount of property. We have one piece sold for almost double what we paid for the property originally, which is a frontage piece. We have a piece in the back under contract at about 40% over what we paid for the property. We'll have an additional piece there for sale. In Pearland, we still have both of those properties listed for sale. We do not have a contract on either yet, but there's a lot of road construction going on right down there. We bought the land really cheap, and we knew it was going to be a considerable amount of time that we probably have to hold the land, up to about 18 months. It's been about 12 so far. I think in the next six months, as that construction starts to complete, we'll see activity on that property down there as well.

Q: That's great. Thank you very much, guys, awesome.

Operator
[Operator instructions]. Our next question comes from the line of Adam Wyden with ADW Capital. Please proceed with your question.

Q: This is just a follow-up on the last question here. I guess you have some real estate that's held for sale today that you expect to make a profit on, in some capacity, that will be in your free cash flow, and then some real estate is kind of under development, but not quite held for sale. Can you try and quantify over the next, call it 12 to 18 months, how much cash you can take out of real estate sales maybe, not just profit, but actual cash?

Eric Langan – President and CEO
I mean, it's really hard to say because, obviously, I don't know when things will close, but if we sold everything, if we sold all $15.7 million worth of property, and we got what I consider our minimum ask price on it, probably an additional $4 million to $6 million in cash, and we'd eliminate another $10 million in debt or so.

Q: What you're saying is, another $4 million above the carrying value?

Eric Langan – President and CEO
Well, above the debt value. I don't know about the carrying value, but yes. Remember, we put cash down. The problem is we built some of the Bombshells on some of this property, so what happens is, let's say there's a loan on the property for $5.5 million, and we sell the excess land, the way the note's written, we have to pay off 100% of the net proceeds to go against the loan. Even though the Bombshells is worth $7 million by itself, we still, the way the note is written, we have to pay off. Now, what we'll do is, come November-December of this year, as Chicago and Pittsburgh become two years old, we will do a big refinance again like we did in 2017, where we'll take all of our existing Bombshells properties, the location in Pittsburgh, the location in Chicago, and probably do a refinance into a large long-term 20-year real estate note, where we'll be able to pull out some of that equity probably on a 75% loan-to-value ratio, eliminate these other loans, and then pay out from there.

Q: Right. They're the higher interest loans that you have outstanding, the $15 million unsecured, you'll be able to basically refi that out and get more kind—

Eric Langan – President and CEO
Right, and turn it into real estate debt against the existing real estate. Kind of like we did in 2017, very similar. We made a whole bunch of notes and then turn it into one note.

Q: Perfect. Let me ask you something else. You guys have about $15 million authorized on the buyback. Your free cash flow, I guess your run rate is about $30, but that probably on some level is burdened by your excess legal and accounting, which we'll kind of get through. When you think kind of forward in terms of closing for Boston and kind of getting out in the back half, I mean, your run rate free cash flow should be materially higher, right, as you pro forma for these accounting costs and kind of Boston? I mean, how do you think about doing anything else with your money, other than buying back stock? This coronavirus, on some level, I guess, is a gift, right, I mean, the stock went for almost $30, something you guys publish in your filings, and now you're back at almost $20. Your free cash flow run rate at the end of the year will probably be closer to $40 than $30. I guess my more philosophical question is, how do you think about doing anything other than buying back stock here? It seems like this is just a wonderful opportunity. I mean, do you think you can anymore—

Eric Langan – President and CEO
As you've seen in the last quarter, that's all we did. We bought back $6.4 million worth of stock. With all the cash flow we generated and all the debt we paid, everything else, we ended up with $1 million less in cash than we started the quarter with and bought $6.4 million worth of stock back. As we move into this quarter, if the stock continues to selloff into next week, we'll be out there buying it I'm sure. If the market wants to continue to discount our assets, we're going to continue to buy them back.

Q: So, is it fair to assume that next week the stock's at $18, that you guys could, I mean, within the guidelines of safe harbor and volume blocks, you could, in theory, execute against all 7% of that in whatever, 14 million or 7% in the next, kind of in this quarter, all things being equal—

Eric Langan – President and CEO
Obviously, we have to have about $8 million to $10 million in cash to operate. We're not going to get ourselves into a situation where we're short cash on hand for operations. But, yes, we would be extremely aggressive. It would depend on if blocks became available. In the last quarter, we had two major blocks come available that we bought from a single investor. If those blocks become available, we're definitely going to look at them. We've now eliminated $10.8 million worth of balloons over the next few years. We have a couple smaller balloons out there still that we're dealing with now. We'll decide whether we're going to try push those or pay those off as we move forward.

The real estate balloons will be paid off with the property sale, so I'm not really worried about those. Right now, we're in a great position where we have the flexibility to basically do whatever we need to do, or whatever we want to do, depending on what the market allows us to do. If the market continues to allow us to buy our own assets at these prices, we will be very aggressive. If they get more expensive, we will slow down. But unless they get fully priced, I don't see us doing a whole lot of stuff other than buying back stock. Obviously, we're going to continue to grow the business at our 10% to 15% clip, but we're doing most of that through debt financing right now. And I think we'll continue to do that.

I think after debt service, even with after debt service right now, we're probably in the $250,000-$300,000 a week in free cash flow after debt service that we can put into the stock. We're sitting on several million dollars of extra cash right now today. And as we close on these other properties, we're going to pick up -- I think the first two properties we pick up about $2.8 million in additional cash. Right now, cash is not a problem for us. It's just going to be a matter of whether we can find available shares for sale, and what the prices continue to be.

Q: Got it. Can you talk a little bit about the last three, four openings of Bombshells, and why you think they performed a lot better than the previous ones?

Eric Langan – President and CEO

We've learned a lot opening ten stores. We have a cookie-cutter floor plan now, so they're almost all identical. We've learned our demographics. We've learned the traffic flows and what's important. The locations that we bought were very, very good locations, very high-traffic locations, class A restaurant locations. The thing of it is, it costs me the same amount to build a store, whether I build it in a class A location or a class B location. Before we were growing, we weren't really as wise as we are today, where we've really learned which locations and what traffic flow patterns we need to do the $100,000 week, $140,000 week store. So, you're doing a $5 million to $7 million store.

I look at a lot of locations that we've passed on that are probably $4 million, $80,000-$90,000 a week stores, so they're doing $4 million-$4.5 million, but it cost me the same amount of money to build that store as it cost me to build that one does $7 million. We're trying to really hold and find the right locations right now, build these stores that will do these higher numbers.

Q: Got it. I think, more or less, you probably committed to not building any new Bombshells this year, kind of showing people the kind of a true earnings power of Bombshells, and kind of showing people kind of a clean year with less legal and less accounting. Looking forward, taking a step back, you've grown this thing from $2 million of EBITDA, whatever it was a gazillion years ago, to maybe next year, exiting this year you'll be run rating close to $60. How do you think about the next move from $60 to $120 of EBITDA? There are a lot of big strip club chains out there, but they're going to cost more than these smaller deals. How do you think about getting your cost of capital to a level where you're not just buying the stock, but you're able to use it to do more transformational deals? What do you think the market needs to see to get you to that next level? Obviously, you had to get your financials in order and all the rest, and that was a prerequisite, but I mean, do you have confidence that you'll be able to get back up? I think before all the financial shenanigans with the nut you guys were trading at 12, 13, 14, 15 times cash flow.

Do you have confidence that if the numbers are in order and the financial components are there, that you'll be able to get the stock back up to those types of levels where you can use it to do more transformational deals?

Eric Langan – President and CEO
That's why we put Slide 12 in there, to kind of show the progress of the capital allocation strategy. What we're going to do is we're just going to keep taking it one year at a time. We're going to keep growing at a 10% to 15% compounding rate of free cash flow, and eventually the market's going to have to recognize the consistency. I think once the market recognizes the consistency, then we'll get the multiple expansion, especially as we continue to prove ourselves over and over. Or what's going to happen is there's just going to be a few shareholders left that won't sell their stock, that have been with us for a long period of time and have seen the consistency, and so, anybody else that wants to own part of this is going to have to pay up for it. That's kind of the reality of it.

Q: I look forward to the buyback, and I'll jump back in the queue.

Operator
Our next question comes from the line of Douglas Weiss with DSW Investments. Please proceed with your question.

Q: Most of the questions I had have been asked. I guess on M&A a little more, could you talk a little bit about how many deals you're seeing and whether the pricing is interesting at this point?

Eric Langan – President and CEO
We're seeing new ones every week. Pricing's not the issue on most. A lot of it has to do with where it's at and those types of things. Some of it's pricing. But we're just taking it easy right now. We have this big acquisition we're getting ready to close. We want to get that done. Our accounting team needs a breather, at least give

them a couple weeks, you know. We'll let them relax for a couple weeks through spring break, get them back to work in April.

We're looking at quite a bit of stuff. There's new stuff every week. I'm getting new emails, new text messages and calls from people, stuff all over the country right now. Really, it's just about finding what fits best for us next. That's kind of what we've been discussing internally at some of these acquisitions that we have on our plate, like which one do we want to really move on next.

Q: Do you think it's better or are you looking at expanding in existing markets, or are there other new markets you'd be interested in expanding into?

Eric Langan – President and CEO
We're looking at both. Obviously, existing markets are easier for us, for the most part. A new market that's close to an existing market, that works out best for us. That way we have supports that's close, but we're also entering a new market, picking up new market shares and in another market. That's why Pittsburgh and Chicago were both very, very good acquisitions for us. Those are the types of acquisitions we're looking at right now, something in that price range as well. We're trying to stay in the probably $10 million to $15 million price range. It's easy.

Q: Right, right. As far as your accounting and accountants, I know you brought in an outside consultant to help remedy the internal controls issues that were cited. Would you say that work is done at this point? Have you kind of implemented their recommendations, or is that still a work in process?

Eric Langan – President and CEO
We're through four out of five of our material weaknesses. It's a constantly evolving, right, because the rules are constantly evolving. And as we grow, we have to make sure our systems grow. The biggest problem we had is we grew so fast, and we were in the process of doing our ERP system, but it hadn't been put in place in'16 and '17, and we just grew so fast that the accounting system couldn't keep up, and as we converted from one accounting system to another, while our numbers all checked out every time, there were no material changes to any of our financials or any material restatements of our financials, but we had to learn. The biggest problem you have as you get larger and larger is you don't know what you don't know, so we had to go through that learning process.

The new ERP system is incredible. I think it gets better, every quarter we find something new that it can do and get better reports. And we're continuing to grow with it and it's very scalable. The nice thing is, to go from where we're at now to double in size or triple in size, this software won't even know, you won't even stretch it. I don't know what numbers, how high we have to get to in revenues before this software has any problems. Hopefully someday we'll find out.

Q: Oil prices have come down quite a bit. Have you seen any impact in your Houston, either in the Bombshells or in the clubs as far as attendance?

Eric Langan – President and CEO
Nothing since January and February for sure. We'll watch and we'll see through March if we have any real effect. We only have really two locations that are affected by oil prices. That's Odessa and Longview, Texas. Longview's a very small club anyway. You wouldn't even know if it's affected. We know, but the market would never know. It's too small.

The Odessa market's a big market for us. Two very large clubs up there, very profitable clubs for us. And so, we watch that, and we're definitely seeing some slowdown in that market on a year-over-year basis. Oil was, I think, $70 last year, it's in the 50s this year. We'll just watch and see. It's still very profitable, still very profitable club for us. Houston's not really affected by oil at all, or really any of our other markets. I think the real markets that are affected, if anything they're helped, because gas prices get cheaper, so people have more disposable income.

Q: Right. I guess the last question is, do you have any thought generally on comps looking out for the rest of the year? It sounds like the sporting calendars might be helpful, but anything you could say there.

Eric Langan – President and CEO
Yes, this quarter. January, February, March are going to be some really nice comps. I think our comps were a little weaker last year. Super Bowl was in Atlanta, so we didn't get any big push from that. We got a huge push from that this year. The NBA All-Star Game this year is big for us. I'm hoping that the college basketball tournament's going to be fantastic for us, too. So, we'll watch as we move forward. And the big fight, the fight last weekend was great. We had a really big, big weekend.

Q: Okay, thanks. Talk to you next quarter.

Operator
Our next question comes from the line of Darren McCammon, a private investor. Please proceed with your question.

Q: A few of them have already been answered. Could I get, I think you already partially answered this, but maybe I can hear it again. You had about a $2.5 million increase in SG&A cost. Could you detail out how much of that was non-reoccurring one time?

Eric Langan – President and CEO
Probably not. To be honest with you, we've been too busy getting everything done and not really looking at what everything costs. In the next quarter or two, yes, we'll be able to break it out, because you're going to be able to see the differences as the costs come down, but the reality of it is, I don't really know. I know a lot of it is accounting, a lot of it's legal, and a lot of it has been, it's overtime. Our accounting staff has been in this office for about eight a.m. to ten a.m. six days a week, almost the entire month of January. Bradley says that the accounting and legal is probably between $800,000 and $1 million of it just by itself, just related to getting the 10-Ks and stuff done, yes.

Q. It adds up to about $0.27 a share, so yes. Maybe offline if I could get a little more breakdown and depreciate it, but the $800 to a million is pretty helpful all by itself actually. I'm going to ask the same thing I asked couple weeks ago. You're at a $9 million run rate on your free cash flow, which the way I add up, adds up to about $36 million. Why are you using $30 million for your stock buyback?

Eric Langan – President and CEO
You have to remember we did $9 million this quarter, so we don't have those kinds of numbers in the fourth quarter typically, in the third quarter is usually down a little bit. Let's see how this January, February, March quarter goes, and maybe we'll have some adjustment to it, but I still think pretty much we're pretty close to that $30 million actual run rate. We'll see. I mean, the second half of the year we'll have a lot to tell. It's just hard to tell with all these added expenses where for sure we're at. $30 million's just a number that we're most comfortable with right now.

Q: Fair enough. You're going to look at it again in your second quarter, which is after the March quarter basically?

Eric Langan – President and CEO

Yes, we should put our second quarter results out in May. So, we'll hopefully have a better idea of where we're at and how things are looking in May. If our run rate is increasing, we'll let you know at that point.

Q: Okay. Just a comment. I get confused every time you guys say Q1, Q2, Q3. If you guys use December quarter, March quarter, September quarter, December quarter, it's just easier to keep track of.

Eric Langan – President and CEO
I know, but then I get confused. Yes, I understand what you're saying. This is the December quarter. In the March quarter, which results will come out in May, we'll have a better idea of how these first six months have gone, how the costs are starting to get in line, and I think definitely the June quarter will be the real telltale, because I think we'll have no real outside costs, other ordinary business costs I think in that quarter hopefully. That should be an exciting quarter for us, which those results will be out in August.

Q: Okay. You talked before about doing some ROI modeling on Bombshells. Do you think you'll have that out in May/August timeframe, also?

Eric Langan – President and CEO
It's possible. We'll see how these guys do. They're going to be sitting around here twiddling their thumbs a lot compared to what they've had to do for the last two years. Maybe they'll be able to model some of that for us, get us a good idea of what it's looking like. I definitely want to see the actual cash outlays on all these new stores, what the property purchase is and whatnot, especially as we start selling off these added pieces, so we're getting a bunch of our cash back. It's going to be interesting to see the cash-on-cash returns on these stores.

Q: And you're going to share those kinds of models with us to some extent, both with the property sales and without?

Eric Langan – President and CEO
If we can get them all done and put it out into a format that makes sense, certainly. It is what it is, at the end of the day. If it's great, that's even more reason to show it. It can't be bad; I can tell you because I can see the returns. I know what cash we spent. I think it's going to be a lot better than we've even anticipated as we sell off these properties. And the numbers were coming in so strong from these new stores. New stores are opening at about $150,000 to $170,000 a week in sales. At that rate, even after the honeymoon period's over, those stores are $6.5 million-$7 million a year stores, depending on what they hold out at. We started at $150, $170, and we bounce down to $120, $110, and then climb and hold a steady $130,000, $140,000 a week. We're going to be just under $7 million a unit on those new stores, which are very highly profitable.

Q: I suspect kind of the same thing, but the market's always going to assume the worst unless you give them something concrete. That's kind of why I'd like to see it basically, is to show the market, whatever's true I want to see, but I suspect what's going to be true is Bombshells is a better business than they think it is.

Eric Langan – President and CEO
I think it's certainly starting to show that. We just got bogged down with accounting stuff and didn't have the time to sit here and evaluate every little nuance as we built these new stores. We just, more importantly, said, let's get them built, let's get them open, everything will catch up with itself later. I think that's what we're going to see, like I said, as we get into this June quarter and get into the end of this fiscal year in September. You're going to start seeing those numbers. I think we're going to start hitting our marks, because we're going to hit our 15% to 21% margins. That's our first goal. Obviously, if these stores come into 15%-20% margins, or 18%-21% margins, and we do $45 million in sales, all of a sudden you got Bombshells cranking out $45 million in revenues, and $9 million in earnings. I think that's going to show they pay for themselves pretty quick.

Q: On the M&A front, just an addendum to the previous question, I noticed that you tend to do most of your purchases towards the latter half of the calendar year. Is that just coincidence, or is there something built into it that tends to happen?

Eric Langan – President and CEO
No, everybody wants to sell their clubs in August. This is one of those businesses where in October through March you're going, "This is the greatest business in the world." And then in the summer you slow down, you're like, "Uh-oh." Then, of course, school starts back up in August, and, "We're all dying." You see our fourth quarter. Even our numbers, our fourth quarter is, if you go back through history, our fourth quarter's our lowest revenue numbers. That's when guys start thinking, "Oh, I should get out of this business." Happens every year. Guys start getting really serious about selling their clubs in the summer, August, September starts coming around, they really get serious about it. And by the time we make a deal, do the due diligence, do all the paperwork, get it all closed, we close between November and February typically.

Q: That's interesting. That's all I got. Thanks, guys.

Operator
Our next question comes from the line of Dan Boyle with Schwerin Boyle. Please proceed with your question.

Q: First I want to compliment you on how you've handled yourself through this somewhat challenging period. We appreciate that. Secondly, a question on the acquisition, how it actually works. Are there many other bidders out there for clubs of the sort, like Boston, Miami, or is that just—how competitive are these sorts of deals?

Eric Langan – President and CEO
I'm sure there's other people out there that would love to be in these markets. The trick is coming up with the cash. If you look at our next acquisition, we're putting $11 million cash down to the buyer. We're borrowing that money from a bank, but the seller is still getting $11 million in cash. As far as the seller's concerned, he's getting $11 million cash down, he's carrying a $4 million note. I don't think there's a lot of other buyers out there that have the wherewithal to pull up that $8 million, $10 million, $11 million cash down payments like RCI's been able to do.

Second, I think we have a great track record of closing transactions now, which I think that the sellers are taking note of. Our reputation on not only making the deal, but actually closing the transaction. And all of the sellers, they get paid and they're happy, which definitely, I think, our reputation, and helps us to be able to buy additional clubs.

Q: When you do the, you net the EBITDA that you kind of put out for the acquisition, you're sort of netting out, as I understand it, a rental expense, that's sort of net of a rental expense. Am I correct on that thought, observation?

Eric Langan – President and CEO
Yes. We use what's called adjusted EBITDA. What we do is we take the revenue that they're earning, let's say that the revenue they're earning is $3 million, and then we buy the real estate for appraised value. The real estate's $7 million. We would take an 8% cap rate, or about $630,000. We take that $630,000 off of the $3 million, which would give us an adjusted EBITDA of about $2.4 million. We pay a 3x multiple of that, giving us a $7.2 million purchase price for the business. So, we pay 3x adjusted EBITDA for the business, and then we buy the real estate in addition to that.

I've seen people out there saying, oh, you're paying 6x or you're paying 5x. If you want to look at an overall deal, sure, we're buying $3 million and we're paying $15 million for it, but we're getting that $7.8 million piece of real estate. People want to forget that real estate has real value, and as we pay that real estate down, because since we own it, we pay those mortgages down, we're able to go out and re-borrow that money again at 5%, 5.5%, and take and reinvest that money again in the next deal. And so, each deal, I think, gets a little bit better and a little bit better for us, especially as we're using, basically we're 100% financing.

The reality is, the company's not using a single dollar of its own cash, and they're picking up 3 million in new dollars.

Q: Got it. Thanks for your hard work.

Eric Langan – President and CEO
All right, thank you.

Operator
Our next question comes from the line of Yaron Naymark with One Main Capital. Please proceed with your question.

Q: Congrats on another strong quarter. I guess just looking at your free cash flow, if we look at the current run rate, it looks, I think someone else asked on the call that it looks like you're run rating closer to $36 million of free cash flow, but I understand you're comfortable using the $30 million as a starting point, because there's a lot of puts and takes this year.

Just thinking about that $30-ish million starting point, that number, it sounds to me like it's burdened by, basically, you have preopening expenses from the new Bombshells' locations, you have training costs associated with—those are other preopening expenses I guess, but you have the accounting charges this year and the legal, which sounds like that's a few million bucks. Your maintenance capex sounds like it's elevated this year because you spent money on the Miami locations in anticipation of the strong Super Bowl. You're paying down debt associated with the asset sales that you earmarked when you sell those, so interest expense should go down, and you have the Northeastern Corridor acquisition, as well as, I guess, next year you're going to have the full-year benefit of the new Bombshells' locations that didn't open up until midway through Q1 of this year.

Just thinking through, if I look at a $30 million run rate that you're talking about, that you're comfortable talking about for this year, is there any reason to think that the run rate entering next year, assuming you don't do any more M&A, or don't open any more Bombshells, won't be decently higher than that $30-ish million, or the $36 million that you're run rating?

Eric Langan – President and CEO

I agree if we were giving a '21 run rate, yes. The '21 run rate will definitely be higher than the $30 million 2020 run rate is. There's a lot of one-time stuff in '20 that should not carry over into '21. So, our run rate going forward into '21 is definitely going to be higher than $30 million.

Q: And then, any M&A on top of that would be incremental. So, you're going to be at a run rate above this year going into next year, and then if you do M&A that'll be incremental, correct?

Eric Langan – President and CEO
Correct. And the idea is that we grow that at a 10% to 15% clip. We need enough acquisitions that we increase that run rate at a 10% to 15% annual growth rate.

Q: Got it. And then, if you guys were able to get back to, I think in 2018, you guys were trading at a double-digit EBITDA multiple before all this stuff started to hit the stock price. If you guys got back to, I don't know, 11-12 times EBITDA, what you were selling at 18 months ago, I mean, do you think it's possible to accelerate M&A and do potentially bigger deals if you're able to pay up with stock, and if you're able to buy stuff at 3 to 4 times EBITDA by issuing a little bit of stock, instead of paying 3 to 4 times, you're willing to pay 5 or 6 times if you're selling for 11 or 12 times; I mean, do you think that would help you accelerate M&A, or if you're willing to pay a little more, it wouldn't—

Eric Langan – President and CEO
Well, it wouldn't hurt. Anytime we're willing to pay a little bit more, we're going to have more deals on the table, number one. Whether we want to use equity or not, I don't know, but if I didn't have to use my stock, if I didn't have to use my cash to buy back stock, my cash would be building up. If I hadn't bought back $6.4 million of the stock because the stock was trading at $34 right now, and so, my $6 million or $7 million in cash was sitting on the books, I could do a much larger deal where I use $10 million of company cash, $10 million worth of bank debt, and another $8 million or $10 million worth of owner financing, and I could be doing $30 million transactions, and still not use any equity. But we have to get a much larger transaction. There's definitely benefits to our equity trading at a fair market value.

Q: Are those out there?

Eric Langan – President and CEO
They're out there, oh, yes, if we want to come up with the cash. Like I said, there's deals out there, they're just going to require, some of the larger, I call multi-club operators, they're going to want a considerably more amount of cash down. They're going to want $20 million, $30 million in cash down on a $40 million, $35 million acquisition, close to 50%, 60% cash down. And so, those are the type of things we're looking at, and I think we'll get there.

In the meantime, we found some nice, basically one-off acquisitions. We're buying one club at a time, and we're continuing to hit our growth rate. The only concern for me right now is, do I have the next acquisitions lined up so I can continue to grow at that 10% to 15% growth rate?

I want to take Slide 12, and I want to run it out 5 more years, and I want to continue to see that compounding growth rates growing, where free cash flow is doubling in 5 years, every 5 years or so. We can keep that going, where we're doubling free cash flow every five or six years, then I think the market cannot continue to ignore the opportunity that we've created, and they'll have to start rewarding the share price for it.

Q: I guess the follow-up to that is, so you say there's these $30 million acquisitions, or even bigger where you need to put down more cash, if your stock was at 12 times EBITDA, do you think those sellers will be willing to accept equity as a down payment?

Eric Langan – President and CEO
Oh, they want equity now, yes. I don't think we'd have a problem using our equity. We used it for years. It's just the problem is, the math doesn't make sense because our equity's the most expensive form of capital we have right now, especially when we're getting back up there, where it's going to get down to—at 32 it's at 10%. I'm borrowing at 5%, 5.5%, and I get a 22% tax benefit on that, so my true cost is 4%, 4.25% on the capital, so why would I want to use an equity that's costing me 14% or 15% right now, when I can use debt that's costing me 4%? That's really the key with using equity.

But like you said, if we were trading at 12 times cash flow, now all of a sudden it might make more sense. We will look at it, we'll do the math. The beauty of it is all fifth grade math. We just figure out the cost of capital and we use the cheapest capital we can, because that's what gives us the highest return.

Q: Right, okay. That's all I have. Thank you, guys.

Operator
Our next question is a follow-up question from the line of Adam Wyden with ADW Capital. Please proceed with your question.

Q: This is just a follow-up on Yaron's question, I think. I mean, I totally get your math in terms of, and it's like music to my ears. It's like when a CEO says, hey, you know, 5% debt money with a 22% tax yield, that's great. I think what Yaron might be getting at, and perhaps what I'm getting at, is that there's a balance in terms of optimal capital structure, as it relates to, investors like to see a certain amount of—they don't like to see companies excessively leveraged. Even though you can borrow at 4%, there's a limit to the amount of transactions you can do as it relates to the gross amount of debt or net debt to EBITDA.

So, I think maybe the question is, and maybe the question I have, is that, if you could get your equity cost of capital—I haven't done the math on 12 times EBITDA, but I can probably do it. If you have no capex, it's roughly an 8% pretax yield, and after tax it's 6, right? So, if you could trade at 12 times EBITDA, that's a 6% equity yield, and you are able buy assets at a 10%, 12%, 15%, it would actually avail you of the opportunity to buy things faster, because you wouldn't have to wait for the deleveraging.

I guess the question is, if you could access equity at an 8%, a 9%, a 10% pretax and after tax, whatever, that would allow you to, as you said, not have to wait for the cash that you're kind of filling up on your books as it goes. You could buy something big and give equity to the seller, or more importantly, I don't know if you ever done this, but go to a bank and say, hey, I want to raise $30 million to buy X, Y, and Z club. I mean, I don't know.

Eric Langan – President and CEO
We did it in '07 and '08. We're very familiar with it. If our equity gets to the point where it's cheap for us to use equity, we can use equity. We're not adverse to issuing equity. We're only adverse to issuing equity at a high cost. If we could find the right acquisition, of course, it would make a lot of sense. I mean, if we're getting 22%, or say we're buying at close to 5 times, we're getting a 20% yield and we're able to do equity, even at 8% cost like you said, we're still getting a 12% spread there. And if we're doing it in a large-scale transaction, a $60 million acquisition, or $70 million acquisition, all of a sudden, yes, it makes a whole lot of sense, because that's a pretty big number when you look at the spreads.

Q: And as you get larger, presumably, I'm sure the multiple, there's more diversity, you're more diverse geographically, I mean, a $60 million EBITDA business is worth more than a 10, and a 120 is worth more than a 60. So, the bigger you get, the more justification you have for a better cost of capital and multiple.

Taking a step back, how many large club chains are there in the United States? How fragmented do you think this whole thing is, and how many $10 million plus EBITDA chains that you would be interested in; I mean, how many of those exist in the United States right now?

Eric Langan – President and CEO
There's several. I don't know off the top of my head. I think there's probably 500 clubs that we'd like to own. Out of those 500 clubs, 300 of them are owned by probably less than 40 people. There are definitely some significant acquisition targets out there when we get serious about it.

Q: What you're saying—you have to have cash?

Eric Langan – President and CEO

Yes, when we have that kind of cash available to us, we could go start knocking on different doors. We knock on the doors that we can knock on. It doesn't do any good to knock on a door if I can't consummate a transaction with the seller that I know the seller would be interested in. So, we haven't really talked to too many very, very large operators out there because we're just not in a position, I think at this time, to really close a transaction with them.

Q: So, we have to figure out how to get back to trading at 12 times EBITDA again. That's the answer.

Eric Langan – President and CEO
Consistency, yes, but that is the answer. We have to stay consistent.

Q: Good, all right. Well, that's it. That's it for me. Thank you.

Operator
Are there any final questions? This is the last chance for questions. There are no further questions in the queue at this time. I'd like to hand it back to management for closing remarks.

Gary Fishman – Investor Relations
Thank you, operator, and thank you, Eric. Thank you everybody who called in their questions tonight. We've included a few supplemental slides in our appendix. We'll also be meeting with investors and presenting on March 26th in New York at the Sidoti Spring Conference. If you are a professional investor and would like to have a one-on-one with management, please let me know. Just email me. We might also hold a meet management that night at Rick's Cabaret in New York. That hasn't been decided yet.

On behalf of Eric, the company, and our subsidiaries, thank you very much for calling in and listening to us tonight. As always, please visit one of our clubs or restaurants. Thank you.

Operator
Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time. Have a wonderful day.