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Transcript of
RCI Hospitality Holdings, Inc.
Fourth Quarter & Full Year 2017 Earnings Call and Webcast
February 14, 2018

Participants

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Philip Marshall – Chief Financial Officer
Gary Fishman – Investor Relations

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Marco Rodriguez – Stonegate Capital Markets
Frank Camma – Sidoti & Company
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Presentation

Operator
Greetings, and welcome to the RCI Hospitality Holdings Fiscal 2017 Fourth Quarter 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. 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, Devon. Thank you, everybody, for joining us today. I want to remind everybody our Safe Harbor statement is posted at the beginning of our conference call presentation. It reminds you that you may hear or see forward-looking statements that involve a number of 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 afterwards.

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

Eric Langan – President and Chief Executive Officer
Thank you, Gary. Good afternoon, everyone. Please turn to slide 4. First of all, we want to thank everyone for being on the call with such short notice, and we want to thank our shareholders, who have stuck with us through all of this, who have believed in us, and have helped maintain the value of our stock. We have worked really hard the last three years building shareholder trust and confidence. We have worked hard to learn from the lessons of the past mistakes, and applied our capital allocation strategy to ensure we continue to increase free cash flow and long term shareholder value. We believe the efforts have begun to really pay off, and we plan to work even harder for you in the years ahead.

Now let's turn to today's news. We are pleased to finally file our 2017 10-K. We are working diligently to file our first quarter Q in order to get back on schedule by the second quarter. This is the first time since I've been CEO that we have been late, and I've been as frustrated as all of you. There was one item that didn't have much bottom line impact, but it took a tremendous amount of time to figure out, and I'll tell you about that in a minute.

While our year-end audit with a new accounting firm took longer than anticipated, the good news is that with our new financial reporting system, we now have a modern, easily scalable financial IT backbone. GAAP results for the fourth quarter were a loss of $0.23 per share. This reflects non-cash impairments and additional tax provision. However, core results for the fourth quarter were strong, with non-GAAP EPS at $0.36.

Importantly, free cash flow for the year came in at $19.3 million, exceeding our initial target by more than 7%. This strong core performance is continuing in Fiscal 2018. We are definitely feeling a more confident, stronger growing economy aided by the enthusiasm generated by tax cut bonuses. As a result we have increased our Fiscal Year 2018 free cash flow target by 9.5%, to $23 million. This incorporates our preliminary estimate of the impact of the tax reduction. The new law is expected to significantly reduce our rate and also result in a non-cash gain. And once the first quarter Q is filed, we'll get back to the acquisition trail.

Please turn to slide 5 for an analysis of our fourth quarter '17 GAAP and non-GAAP operating income. Revenues were very good, up close to 19% in both our Nightclubs and Bombshell segments and up close to 19% on a total company-wide basis. Key factors were growth in same-store sales of 6.5%, as well as new acquisitions and a new Bombshells, and strong marketing related to televised pro baseball, football, boxing, and mixed martial arts sporting events. All core revenue lines also grew, with higher margin service revenues, beverage, and food up in double-digits.

GAAP operating income increased 87% to $1.4 million. As I mentioned, this included $6.2 million in impairments versus the year ago quarter, which included $5.2 million in items. Looking at the quarter on a non-GAAP basis, operating income increased more than 26% to $7.7 million. By order of magnitude, the key drivers of this increase were the Nightclubs segment, which reflected higher sales from acquisitions, in particular Scarlett's Cabaret Miami; increased same-store sales; expanded margin due to better operating leverage; and a better lineup of clubs in general versus the year before. The Other segment, which saw a big improvement as a result of our divestiture of Robust last year, and the Bombshells segment benefitted from higher sales, expanded margins, also due to better operating leverage and improved restaurant lineup.

During the fourth quarter we successfully launched our new, larger Bombshells on Highway 290 in Houston. This replaced a smaller, more distant unit in Webster, which closed at the end of the year-ago quarter. Also worth noting, during the quarter we successfully dealt with severe hurricanes in Houston and South Florida, two of our major markets. While we don't have specific dollar amounts, we believe the hurricanes resulted in a relatively small amount of lost operating profits and additional expenses.

Please turn to Slide 6. Fourth quarter '17 impairments totaled $6.2 million. About $3 million was for two clubs in East and West Texas, and another was for $1 million for our Fort Worth club. All of these clubs are profitable, but less so in fiscal 2017. Another $1 million was for the remaining investment in Robust. The remainder was spread among three other properties, one of them non-income-producing.

The other item affecting GAAP results was $1.3 million in additional non-cash taxes. This resulted from the tax effect of a 2% increase in our tax rate on our October 1, 2016 timing differences between booked and past accounting. As a result, our fourth quarter '17 effective tax rate was a $1.1 million tax expense on a pretax loss, making our Fiscal Year '17 effective tax rate 43.4%. This compares to a $1.3 million tax benefit in the fourth

quarter of '16 on a pretax profit, making our Fiscal Year '16 effective tax rate 18.5%, which included the benefit of about $2 million in tax credits.

The big item that required the most amount of time during the audit was the review and resolution of non-cash deferred taxes we announced at the end of December, and to a lesser extent the non-cash depreciation item that we discussed at the same time. Resolution of the tax and depreciation items resulted in net after-tax effect of increasing Fiscal Year '16 net income by $129,000, reducing Fiscal Year '15 net income by $98,000, and corresponding adjustments in the 10-K to the Fiscal Year '16 and Fiscal Year '15 income statements and balance sheets.

Please turn to Slide 7. Fiscal '18 is off to a great start. As previously announced, first quarter '18 club and restaurant sales increased 22% year-over-year and same-store sales grew 7% year-over-year. Nightclubs increased 20% in total sales and 7% on a same-store basis; while Bombshells grew 36% in total sales and close to 6% on a same-store basis. New units added more than $5 million in sales, primarily due to Scarlett's Cabaret Miami posting the best quarter results since we acquired it in the first full quarter of the Bombshells 290. Positive trends have continued to date into the second quarter. In January, we had good business even though we had tough weather in some markets. In February, we had good sales related to the pro football championship in multiple markets. We will announce second quarter 2018 results for club and restaurant sales on April 10th.

Bombshells celebrates its fifth anniversary in March. We have three new units in various stages of development in the Houston area. This would give us a total of eight units in Texas, of which six will be in Greater Houston. The first of the new units is scheduled to open in the rapidly growing suburb of Pearland in the current quarter as soon as we can connect gas lines and pave the parking lot. This will be our largest Bombshells to date, with 13,000 square feet, and seating capacity in excess of 400. The other two Bombshells, on I-10 and the Southwest Freeway, are scheduled to open in the fourth quarter of fiscal 2018, and the first quarter of fiscal 2019. We also have a new menu rolling out with the first price increases we've implemented in several years.

The new federal tax legislation will definitely enhance our results, but that might be mitigated to some degree by pressure to increase salary and wages. Our effective tax rate is expected to fall to approximately 23% in Fiscal Year 2018. It will also result in a non-cash gain of approximately $10 million in the first quarter of '18 due to lowering the rate of our deferred taxes. As I mentioned, it should also enhance free cash flow as well as our club businesses.

Please turn to Slide 8. Another major plus is our new real estate consolidation loan with Centennial Bank for $81.2 million that we signed late in the first quarter. It simplifies our debt structure, locks in at an attractive rate, pays off a significant amount of higher-rate non-real estate debt, and eliminates multiple balloons over the next four years. This includes the one on our prized Miami Gardens location, where Tootsie's Cabaret is located.

The new loan stabilizes debt-servicing cash outlays on debt at $9.84 million in each of the first two years. That represents a savings of $1.57 million in principal payments, and $612,000 of interest in year one. Starting in year 3, debt-servicing cash outlays drop to $6.84 million per year for the balance of the loan. Initial loan-to-value was 75%, and by month 24, drops to 64% with the additional principal payment.

Putting together this loan required extensive independent documentation. This included surveys, environmental studies, appraisals of all the parcels and facilities involved, providing thorough third-party due diligence of our real estate. Although we believe many of the valuations were on the low side, based on our experience, having this type of third-party analysis is beneficial to the company and its shareholders, and there are no restrictions on using debt to acquire new clubs that are accretive to earnings.

Please turn to Slide 9. This slide shows the estimated effect of the new loan on our long-term debt. There are three major changes compared to what we showed on our last conference call. Real estate debt went up by about $13 million, reflecting how we used the bank loan to unlock equity on existing real estate to refinance higher-priced parent-level debt and the Jaguars seller financing. As a result, parent-level debt is down by about a third, and the Jaguars debt, which was $7.5 million at the end of the third quarter, has been eliminated.

Please turn to Slide 10. This slide also shows the effect of the new loan on debt maturities. The main thing I'd like to point out is the significant reduction in realty balloons compared to what we showed you on our past conference call. In particular, a $19.4 million realty balloon mainly related to the Tootsie's Cabaret in 2020 is gone.

Now please turn to Slide 11. We continue to demonstrate good cash-generating power. For the quarter, adjusted EBITDA increased more than 17% to $9.6 million. Year-over-year, it's up more than 8% to a record $37.3 million. Cash was $10 million at September 30th, or about $1 per share. This is down a little from June 30th, but mainly due to higher prepaid expenses.

Fiscal 2017 free cash flow at $19.3 million exceeded our original expectations for the year by about 7%. As I mentioned earlier, based on the strength of our business and a preliminary analysis of the impact of the new Tax Cuts Act, we have increased our Fiscal Year 2018 free cash flow target by 9.5% to $23 million, which would represent 19% year-over-year growth.

Please turn to Slide 12. Here's a review of our capital allocation strategy. With an estimated free cash flow of $23 million, and a market cap of about $27 million, we currently have an after-tax yield of about 8.5% on our equity. This is what we consider our risk-free return for buying back our own assets in the open market. At that yield, we are more likely to use capital for club acquisitions or to open Bombshells. To compensate for the added risk, our hurdle rate continues to be at least 25% to 33% cash-on-cash return, unless there is a significant strategic rationale.

If an existing unit is not generating a sufficient return we are inclined to dispose of it, free up as much capital as possible, and use that for more productive purposes. Should our free cash flow rise, or our stock price reach a point where the yield is in the double-digit percentage range, we would seriously look at returning our focus to buying back shares, and with the lower tax rate, the after-tax yield of paying down debt also increases. If we can't find the right acquisition as cash builds and our stock yields stay below the after-tax yield of paying down our 12% debt, we will look to retire higher interest loans.

Please turn to Slide 13. Looking ahead, we have a great future built on four pillars.

One, grow our free cash flow per share at 10% to 15% year-on-average, and grow our total free cash flow to approximately $30 million.

Two, acquire more great clubs in the right markets. On average, over the years, we have made more than one club acquisition per year. We are currently in discussions with multiple potential candidates.

Regarding organic growth, continue to expand Bombshells' company-owned stores. Our target is three per year. Over the next three to five years, that would give us a total of 14 to 20 units.

And fourth, while we are in growth mode, we will not be pressured into deals that we don't like just for the sake of growth. We are not in a hurry. We will work to make sure that each new acquisition or restaurant is right for us. It has to meet our requirements, add to achieving our long-term goal, and not add undue risk or stress to our systems. We will be focused, analytical, careful in everything we do for our shareholders.

Thank you for listening, and thank you to our staffs across the country for all their hard work, volunteering during the hurricane, and all those that were involved in closing out this year. Now let's open the call for questions.

Operator
At this time, we will now be conducting a question and answer session. [Operator instructions]. One moment, please while we poll for questions. Our first question is with Marco Rodriguez with Stonegate Capital Markets. Please proceed with your question.

Q: Good afternoon, guys. Thank you for taking my questions. I'm wondering if maybe we can start on the impairments you guys took in Q4 '17. I'm just trying to get a little bit of clarification here. Those five operating units where you took the impairment charges, are they still in operation or have you exited them?

Eric Langan – President and Chief Executive Officer
Yes, they are [still in operation]. The main [ones were] three units, one in East Texas, one in West Texas—those are very affected by oil prices—and then one in far west Fort Worth, in which we just had an off year. We've made some adjustments, and I think that '18 will be better, but we have to use the formulas and do the snapshot as of 9/30/17.

Q: Okay. So you exited those clubs, or you just took a charge because—?

Eric Langan – President and Chief Executive Officer
We [did not exit the clubs], we took a charge. They're profitable, they just weren't as profitable as the year before, and so based on the rules, we have to run the calculations and impair when necessary.

Q: Yes, sure. Okay, I understand that. And then the other three properties, one of which was non-income-producing, what exactly were those other two that were income-producing?

Eric Langan – President and Chief Executive Officer
I believe they were just tenant properties, and—it was due based on certain appraisals mainly in Texas and mainly due to, I believe, just the oil effect that happened in 2017.

Q: Got you, got you. Okay. And then moving here, just to the bigger picture items here on Bombshells, it looks like in your presentation, Q1 same-store sales were pretty strong at 6%. I was wondering if maybe you could talk a little bit about that, that rate right there compared to Q4 2017, where you were at a 2% same- store sales. What were the big drivers there that you saw?

Eric Langan – President and Chief Executive Officer
Well, the sports lineup was much better. Of course, the Houston Astros going to the World Series, that certainly didn't hurt. I think we also got a nice benefit—I hate to say anybody benefits from a hurricane—but we were one of the first restaurants reopened, we were very active with first responders, and I think we just got a nice boost from that. That helped our numbers. By doing the right thing, we benefited.

Q: Got you. I know you commented that you don't have exact figures as far as the impact from the hurricane, but do you think that there's any meaningful impact to the same-store sales in your Q4 1'7?

Eric Langan – President and Chief Executive Officer
No, not particularly. I just think we had a strong quarter.

Q: Got you, got you, okay. And then moving along here to the franchise opportunity on Bombshells, can you provide us with an update there, where you guys are in terms of opportunities, to selling some franchises out there in the states?

Eric Langan – President and Chief Executive Officer
The market hasn't really changed. Casual dining is still a very tough market, and we're not seeing a ton of interest. We talk to people here and there, but nothing solid at this point. Right now, I think, we're just going to stay focused on building out these next three company stores, which will push us all the way through the first quarter of '19, so about a year from now. As we look into the next few months, we will start figuring out, probably when the Q comes out, or definitely by May, we'll be able to give you a nice update on our plans as we move toward expansion in 2019.

Q: Got you. Are there any—I don't know—strategic re-evaluations in terms of how you guys approach the franchise opportunity?

Eric Langan – President and Chief Executive Officer
Not really. I mean, I think right now it's just tough. We're talking about approximately a $3 million investment in the casual dining space, and it's just a tough sale currently. I do believe as certain franchisees of other operations are in long-term leases, and starting to look for exit strategies from failing franchises, that maybe we'll get some more interest. We'll just have to see. Or, as the economy comes back and kicks up, maybe casual dining will pick back up, and we'll see interest at that point.

Q: Got you, okay. And then a question here on the Nightclubs segments. Same-store sales growth also pretty positive here in Q4/Q1. Obviously, you've called out some sporting events, maybe the Grammys also helped you guys a little bit here in Q4, I believe, it was. Were those the primary drivers for the same-store sales increases there, or did you have any sort of promotional activities or marketing activities that maybe kind of helped that as well?

Eric Langan – President and Chief Executive Officer
No, I just feel that there's more optimism out there, especially in small business owners. The talk of the tax cuts and that type of stuff, I think people were just more optimistic in October-November-December. We've seen that in the sales, and we've definitely seen it in that quarter. For the fourth quarter, we just had good sales as well. Things seem to be turning more positive.

Q: Got you, got you, okay. And last quick question, just a housekeeping item, if I'm looking at this correctly, it looked like your SG& A in Q4 '17 was at roughly $13 million and some change; a decent uptick sequentially and year-over-year compared to where your SG&A has been historically. Were there any sort of one-time items in there? Can you kind of talk a little bit about that, or is that kind of a new run rate level?

Eric Langan – President and Chief Executive Officer
I do believe there are added expenses. We did put our ERP system in place, so there was a lot of consulting on that. Of course, we switched auditors; we had some other stuff, I believe, in legal that picked up just a little bit.

But overall, I think that we're going to probably normalize down from this level, if not in this next quarter. Once we get through the October-December quarter or through this January-March quarter, I think definitely we will normalize more in the April-June quarter. So, expect a little fluctuation here as we settle into the new normal, especially the new accounting systems and whatnot.

Q: Got you. Thanks a lot, guys, I appreciate your time.
Eric Langan – President and Chief Executive Officer
Yes, thank you.

Operator
Our next question is with Frank Camma with Sidoti. Please proceed with your question.

Q: Good afternoon, guys. I think one of your best moves, if rates continue to rise here, might be the debt, what you did there, so I have a couple of questions around that. One is, is this—this is substantially all of your real estate, is that correct?

Eric Langan – President and Chief Executive Officer
I would say it's about 90%. I don't know the exact numbers, I'd have to really kind of lay out, but it's about 90%. It's the majority of our real estate.

Q: Yes. That's fine. That's fair. You make a comment about no restrictions on using debt to acquire further clubs which are accretive; that's a little bit different. Typically, you see a leverage covenant or something like that. Can you explain that? What do they look for there, just sort of in the cash flow metric or—?

Eric Langan – President and Chief Executive Officer
Is it 1.25, it's 1.25 to 1, is that correct, Phil?

Phillip Marshall – Chief Financial Officer
Yes, 1.25.

Q: Yes, okay. Oh, is –that's the metric you're looking for? Okay, okay, good. All right, good. My other question is on the club business. This is more from an acquisition standpoint, this question is coming from—given the increase what you've seen in sort of consumer confidence, small business confidence, the tax cuts, and obviously, the improvements in your business, do you get a sense, and I know you talked to a lot of club owners out there, do you get a sense that they may want an elevated valuation in the short term, or how are they thinking about their business? Do they think differently or on the opposite side?

Eric Langan – President and Chief Executive Officer
I think we've typically been around three times EBITDA. In special situations, with grandfathered licensing, we've gotten as high as four, similar to the Scarlett's deal. We'll take a trailing 12- month adjusted EBITDA-type deal. If we believe there is some additional upside, we can make an adjustment for that, and it might seem like we pay a little bit more around the trailing 12-month basis, but I don't see us exceeding that 3-times to 4-times range regardless on a trailing 12-month basis.

We can never be certain on what the future is going to be, so we basically look at the cash flow we generated from the past, and that's how we've been negotiating. I think we're one of the real—only real cash buyers out there. We haven't done much acquisitions since Scarlett's, and we're starting to build a significant amount of cash on the balance sheet, as you'll see, once we get the Q out here, hopefully by end of the month, early March,

and get back in, and then in May, you'll see it nice and solid if we haven't made an acquisition. Our cash is definitely building right now.

Q: Okay. Well, at that multiple it leaves you a decent bit of margin as safety, I guess, that 3x to 4x. I guess where I was going with that is are the sellers feeling a little more comfortable, or maybe even does the lower tax rate get them sort of off the margin, not that they really save on the capital gains, but I guess some of these guys would have embedded when they sell, they might—

Eric Langan – President and Chief Executive Officer
We can adjust for their tax—we can adjust.

Q: Right, right. It might net them more is, I guess, what I'm saying under the new tax law. Okay.

Eric Langan – President and Chief Executive Officer
Most of the guys we're talking to who are selling are looking to get out of the industry. They want to retire, they're looking, so of course, they're always trying to get the most value they can get, but they also want to make sure they get paid. That's one of the things that RCI as a public company, and our past history, and our track record, they have the confidence in us that they will get their money. If not all at once, they will get their money based on the terms that we negotiate, as we've done many, many times.

Q: That's not necessarily a bad thing for them if you're able to give them a note and pay them over time, right, because they can get like an installment sale, for example, on their side.

Eric Langan – President and Chief Executive Officer
Exactly. They save on their taxes. They get additional guaranteed interest versus having to take a lump sum of cash and try to invest it and match the 6%, 8% or 10%, depending on how we do the notes. So yes, there are definite benefits in dealing with us on a long-term basis for them as well.

Q: Okay. I appreciate your comments on the franchising. It doesn't totally surprise me, but if you could boil it down to like a couple of things—you did call out a couple of things—but I'm just wondering, because your approach at the size of these that you're looking for, I think you're approaching experienced investors or operators. Do you find that they come across any common themes, whether it's the size of the investment or the track record, which is more important to them?

Eric Langan – President and Chief Executive Officer
I think the big thing right now is we only have a few stores in the Houston market, and as we continue to dominate in Houston, and we can show that when you open up more stores in a market—because we really are trying to do area agreements—and I think as the new Houston stores open, our old stores are staying solid. We're seeing the sales growth and the excitement of the new stores throughout the chain.

As we open more stores then we're going to be harder and harder to ignore—the success. When you do it once, or twice, or three times, it's one thing, but as we start getting 8, 9, 10, 11, 12 stores open, I really think we're going to start seeing some really solid players, especially as we move into '19. I really was hoping to do it sooner, but maybe we jumped the gun a little bit, got ahead of ourselves, and we just need more time under our belts, more total revenues under our belt. When we're doing $50 million in revenues from the restaurants, a $3 million investment looks a little different than when you're talking about a company that's doing $20 million in revenues on their existing stores. I think that we're building that confidence.

Q: Sure, and that takes a while, I understand.

Eric Langan – President and Chief Executive Officer
We're staying in front of them. That's the main thing right now. So, when people are ready to look for new stuff, I think we're going to be on their list to visit, for sure.

Q: Okay, and my last question is, just if you can refresh my memory here, I know you put out the new free cash flow target. I see the operating cash obviously went up. Was the maintenance capex the same at $2.5 million, or did that go down? Can you just remind me?

Eric Langan – President and Chief Executive Officer
Yes. We've held that. It was a little less than that last year, but I believe, on a go-forward basis, $2.5 million is a solid number.

Q: Okay, so there are no clubs that need any—that number doesn't seem strikingly high to me. There are no clubs that need any major—?

Eric Langan – President and Chief Executive Officer
You know what, we can redo an entire club for about $200,000. A typical, what I call update runs around $100,000, and we can redo 25 of the 45 locations.

Q: Right, except for the club in New York, which will probably cost you that whole amount.

Eric Langan – President and Chief Executive Officer
In fact, we've just recently did an update on the whole entrance way. We've redone the entry way, and we're redoing some other stuff in New York right now, and probably—I'd have to check with Ed to get the total numbers—but from what I've seen going out right now, probably about $28,000 or $30,000 so far. Yes, you'd be surprised. I mean, chairs, furniture, carpet, paint—it's not extremely expensive. It's not as if you have to replace the whole kitchen, right? I mean, we might replace a few of the lights, but we don't have to rewire the system. No, the expensive stuff is there, it's just minor upkeep.

Q: Okay. Great. Thanks, guys.

Eric Langan – President and Chief Executive Officer
Thank you.

Philip Marshall – Chief Financial Officer
Thank you.

Operator
[Operator Instructions] Our next question is with James Anderson with R.F. Lafferty. Please proceed with your question.

Q: Hi, afternoon, guys. Congratulations on some pretty strong results here. It's a shame that the auditor caused so much trouble for you guys and I think the little perception in the market, but very impressive stuff here.

Eric Langan – President and Chief Executive Officer
We really don't blame the auditor completely. It was a very complicated tax issue that took a lot of time to figure out, and we had to get it right. It wasn't something I could break out my calculator on my iPhone and do, so there was a lot to it. The good news is, it's out and our numbers are right, and had very little effect on any of our numbers or cash flow, which was just the metric we use.

Q: Yes, and definitely better to get it right the first time, I think. I noticed in several of your segments, both Bombshells and your Nightclubs, that you had really strong same-store sales growth. I think somebody else commented on that; pretty far outside or above what you would expect in other casual dining or a consumer discretionary chain growth. Is that because—the 6.9% growth obviously can't continue indefinitely, so where do you see that leveling off to, where do you see it moderating a little bit, and what's really driving that?

Eric Langan – President and Chief Executive Officer
I think if we stay at 3%, we're great right now. Of course, if inflation starts are jumping up again, then of course we want to say ahead of inflation, right? That's the key to it. It's hard to say. We've always had cycles. If you look at our history, we'll have a six, eight, ten up-cycle quarters, and then we'll have three, or four, five down quarters, minimum half, another cycle of six, eight up-quarters, so it's always fluctuated. We are affected by sporting events, we are affected by business travel, and certain other things, and of course, consumer confidence; especially small business owners.

Q: Yes, yes. Now that you are sort of shifting a little bit—or not shifting, but including restaurant sales and food sales as a larger portion of your overall revenue with the growth of the Bombshells segments, have you guys noticed any sort of price pressure from inflation on your supply side in terms of food, chicken, or anything like that?

Eric Langan – President and Chief Executive Officer
Chicken wings got expensive for us. Avocados got expensive for a little while, but we're starting to become a larger and larger buyer, so we're getting better and better pricing. We've put out new menus. We've updated our menus and increased some prices where we've needed. Sure, overall, we've seen food and beer squeezed a little here and there, but our guys are on top of it, and we work through it, and when we have to make price increases to cover it, we'll get it done. You may see a point here and a point there for a quarter, and then we'll adjust it and get it back on track the other way.

Q: Okay, that's good to hear. I'd like to talk about the Bombshells again a little bit. Obviously, when you own and operate GAAP profitability is a little different than when you franchise, so what do you see is the breakeven time on a GAAP basis for a new Bombshells. Is it 16 months because it seems like you're going to be continuing to add three new Bombshells a year and you have the older units sort of starting—

Eric Langan – President and Chief Executive Officer
When you talk about total investment, you're probably talking three to five years based on about a $3 million investment, but we're leveraging that now through bank financing where we're only having to put up about $750,000 to $1 million of our own cash to open it up. On a cash on cash basis, which is how we really look at our returns, we're looking at a year, 18 months and some of them even quicker. I think, our Pearland location will be a very fast cash on cash return for us once we get it open, in probably less than one year.

Q: And, just more generally, do you see—I mean, obviously you guys can't have perfect clarity to your acquisition. You said you were in talks with various operators, but it seems like you are pretty committed to growing Bombshells by around three a year. Are there corollaries with the nightclub growth or is that something where

nightclubs can stay between 40 and 45 for the next 2 or 3 years as long as you guys are getting that Bombshells growth, or do you have a target you're looking to hit with the nightclub growth, unit growth?

Eric Langan – President and Chief Executive Officer
No, we definitely are looking to grow. Our target, of course, is to grow free cash flow at 10% to 15% per year, and so when you look at how much revenue we're going to need to buy or how many shares we're going to have to buyback, or where we can cut expenses to make sure that we maintain that free cash flow growth. The majority of that growth is going to have to come through acquisitions, the restaurants are going to help. What the restaurants are going to do is help us steady grow at a minimum level, and then the real growth will come when we make the club acquisitions, as it did with Scarlett's in Miami.

Q: Okay. That makes sense. You had mentioned, previously, that your cash flow growth year-over-year was around 10% free cash flow per share. Are you now potentially increasing that, or you just think there's more upside range, between 10 and 15, or is 15 something we can see going forward?

Eric Langan – President and Chief Executive Officer
Well, I mean it's between 10 and 15 is what we're shooting for. We could see 25 if we make the right acquisition, and we can see 8 if we don't find the right acquisitions and things get tight and we just let our cash pile up because you're not making a lot of money on cash right now. It'll fluctuate throughout the cycle. What we're really starting to look at now is a three to five-year cycle and saying during that three to five-year cycle, we want to see our growth average 10% to 15% per year of free cash flow.

Q: Okay. Capex, you have about $2.5 million projected in capex expenditures going forward. How should we, when we're thinking about that growing in relation to Unical? Obviously, it's spread between the nightclubs and the Bombshells but how should we think of that growing?

Eric Langan – President and Chief Executive Officer
We'll kind of update as we move along. A lot of it was camera systems updating. We're updating electronics and POS systems, camera systems, those types of things. A lot of that work is done. We have a few locations left. Now, we're looking at—we're redoing some parking lots. We added parking lot lighting last year in certain locations. I mean, it's just going to fluctuate, and we're going to try to keep an eye on it and watch it.

If we start getting to the point where we've spent the whole $2.5 million early, then we may give you an adjustment and say, this year is going to run a half million higher because we're making these changes and we're going to make these improvements that we think will return. We don't spend money if we don't think we can make it back. We want to see return on investment, even our capex expenditures, we pay attention to our capital allocation strategy.

Q: It sounds like if there's a good deal, almost discretionary capex going on there, where maybe you could have put off upgrading cameras or there's some margin there, I guess.

Eric Langan – President and Chief Executive Officer
Yes and no. I mean, we have to get—for security purposes and that, we have to have these systems in place, but yes, I mean, whether we do them in the month of April or we do them in the month of May is based on—and a lot of it is also based on when we can schedule and get the people to actually install the system as well, and get the equipment. We have to wait for equipment sometimes. Some of the Bombshells are aging so we've spent some significant money on the Dallas location recently redoing it, and we're going to see audio/video stuff for the

Bombshells will start coming in, so that's why I say, even though we were a little less than $2.5 million, I think $2.5 million is a good number as of right now, for 2018.

Q: Okay, and I just want to speak briefly about the impairments. Obviously, you have some one-time stuff this quarter and I think you'd mentioned there were some, at the end of 2016 as well. I mean, do you think we, with the recent audit for Centennial and for the earnings, do you think you've pretty much gotten most of the impairments out of the way or is that something we should just—?

Eric Langan – President and Chief Executive Officer
I certainly hope so. I mean, at some point we'll have no goodwill left, and then it won't matter if we keep writing it all down. I mean, we are a business in different markets, and different clubs have cycles. Every year, we're required under GAAP to run these analyses and impair, if it's required under the rules. At some point, I was looking at some of these analyses this time, I think we took pretty aggressive write-downs this year, and so I'm hoping that that will cover everything.

The markets that they're in, I know we've seen Odessa come back, so hopefully we'll see the other West Texas and East Texas towns stabilize. I don't think the numbers will go down any more, but you just never know. It's just business, and we'll work through it. I think, yes, to answer your question short, yes, I think we've pretty much touched it.

Q: Okay, great. Touching on Texas and the Bombshells, most of your locations have been in Texas to date. I believe that's correct. Have you looked at other states or other areas, potentially in the south or maybe even farther up north where you might want to expand the Bombshells that you see as fertile areas as of whatever point you finish with expansion in Texas?

Eric Langan – President and Chief Executive Officer
We're going to finish Houston in 2018, so our last Houston location that I have planned right now will probably open in early 2019. Over the next three months we're going to be exploring where to go next. We are looking in Miami, we are looking in Phoenix, Scottsdale area, we are looking San Antonio, Texas, if we stay in Texas, so we're going to be meeting with a team, probably we'll be updating you when the next Q comes out or definitely by the May Q we'll have an update on our plans moving forward for 2019 on Bombshell.

Q: Okay, great. Thanks for that, Eric.

Eric Langan – President and Chief Executive Officer
Thank you.

Operator
Our next question is with Steven Martin with Slater. Please proceed with your question.

Q: Hi, guys. Most of my questions have been answered but can you talk about the real estate you have available for sale in total dollars, and what it looks like?

Eric Langan – President and Chief Executive Officer
I think the two pieces we have left are the Dallas Onyx location, which is about—that's two different pieces of property. One is a parking lot with about 6.8 acres and the other is the club and direct parking for the club, that's another 6-point-something acres. Currently, it's listed with a broker, ask price is $6.7 million. We're negotiating

on that. Then, our old corporate office building is also listed in the assets for sale right now. It is also listed. We have some people looking at it here and there.

We've only received one offer on it. It was an extremely low offer that we passed on, and we're waiting to see, as we move into the year here, if we get more activity on that. Once the Bombshells in Pearland opens, we will be listing the two pad sites on each side of it for sale, probably in the April/May quarter. We also are talking with a group on our I-10 property. We have some pad sites there that we're currently developing. We have to get the retention walls in, but we're currently negotiating a contract right now on a little over 1.5 acres on that site as well, so we will see some activity on that, especially as we move into this summer, I believe. That's when that will get active on the raw land.

Q: If you aggregated all of that for sale, what would you guess would be a conservative value for all of it?

Eric Langan – President and Chief Executive Officer
I'd have to look at what we put in the K. I can't recall off the top of my head. I've read that thing about 4 million times in the last 2 weeks, you'd think a number would pop into my head right now. But roughly, I believe we have a little over $6 million right now, not counting—because we don't have the Pearland land or the I-10 land actually listed with a broker or actively trying to sell it, it's not in assets held. It's still in long-term assets. Once we list those properties, we'll move those over, but if we sold everything, probably it's well in excess of $10 million.

Q: Okay. If you talked about the club business and broke it down into four markets, your major markets: New York, Florida, Minneapolis, and Texas, how would you characterize each one of those?

Eric Langan – President and Chief Executive Officer
Florida and New York are fantastic for us. Minnesota with the Super Bowl has been great this last quarter and this current quarter. We have a lot of exciting stuff going on in Minneapolis moving forward. If there's a weakness in the market, it's probably some of the Texas market, but not overall Texas. Texas is so large, I think it's hard to say Texas is a market by itself. Texas has a lot of submarkets. I'd say Austin/San Antonio is a market, Houston is a market, Dallas/Fort Worth is a market, and then, of course, I call outer East and West Texas are markets.

The outer East and West Texas markets are strengthening as oil is stabilizing at $60. If oil goes up more, I think they'll get stronger. If oil goes back down, they may get a little weaker. The Dallas/Fort Worth market is a solid market for us. Houston really is Bombshells, and it's a restaurant market. We don't have a lot of clubs in that market, and it's been great for us. In the Austin/San Antonio market, the Bombshells hasn't been as strong as we'd like, but the club market in Austin and San Antonio is fantastic. There's a lot of tech in Austin, a lot of new companies moving to that area, and we're seeing very good strength in the clubs in Austin and San Antonio.

Q: Alright. Thanks, a lot.

Operator
Our next question is with Peter Siris, Private Investor. Please proceed with your question.

Q: Hi, Peter Siris. I have a comment to make, not so much a question, a comment and an apology. About 10 and a half, almost 11 years ago, I recommended, in an interview on Barron's, that the company had some really good properties, great brands, and if there was a weakness, it needed to strengthen its management team and depth. I would like to say, I don't know many people who have held their stock for a longer period of time than I have, but I find it remarkable, Eric, how you have grown in this job from where you started to where you are now

in terms of a manager, in terms of a decision-maker for how you allocate capital, and how you make acquisitions. It's like night and day. I just want to say that I am—leaving aside the stock price, the earnings—I'm just so impressed by your growth as an individual, as a leader and as a manager, and I just wanted to make that statement.

Eric Langan – President and Chief Executive Officer
Well, thank you very much, and you've been a big part of it. You've given me a lot of advice throughout the years, and you're one of the first guys that taught me to really get out there and listen to the right shareholders, and the long-term guys that are going to stick with us throughout the deal and that really have the company's best interests and the overall shareholders best interests at heart, and that's what we're really focused on now, instead of the short-term players.

It wasn't easy. It took me a while, for sure, and I made some mistakes, and I really appreciate you believing in me and staying with me through that time and really helping me understand that I need a team, and I built the team, and then my team is really building itself now. It's amazing how quickly, especially as we really put this capital allocation strategy together and started thinking in those terms, how quickly it's come together for us, and I really appreciate it, Peter. Thank you.

Q: The other comment I wanted to make is when you look at a multiple for a company, how you evaluate a company is not just by its current growth, but its sustainable growth, and what I will say is that this company's maturity, the way this company has matured, the way the management has matured, you deserve and hopefully will continue to get a higher and higher multiple fee because you deserve it.

Eric Langan – President and Chief Executive Officer
I appreciate that, and we'll put it to good use if we get it. We've been very fortunate throughout the years and we've tried to stay on top of everything and we're very focused. I think we're probably the most focused we've ever been. We're seeing the best opportunities that we've seen come up, and we'll take advantage of it this time and try to avoid any of the mistakes and pitfalls we've made in the past.

Operator
Our next question is with Ishfaque Faruk with WestPark Capital. Please proceed with your question.

Q: Hi. Good afternoon, guys. A couple of questions from me. I think most of the questions have been answered. Eric, I think you guys updated your capital allocation strategy. In the new one, it shows that you're more comfortable buying shares at a lower free cash flow yield than prior slides. Is that a right way to make that assessment?

Eric Langan – President and Chief Executive Officer
We're looking at double digits. I mean, if we're over 10%, if the yield gets over 10%, I think, currently, that's around the $22 range. We're going to be looking at equity pretty hard. We're generating a lot cash and guaranteed 10% yields in this market, there's not a lot of them.

Q: Yes, yes, exactly.

Eric Langan – President and Chief Executive Officer
We borrow money at 5% so we're getting double the yield on buying back our stock that we're getting on borrowing money, I think it just makes sense.

Q: My point was that in prior quarters you didn't buy back stock when the yield was at 11%, 12% so you're more comfortable at this level to buyback at 10%?

Eric Langan – President and Chief Executive Officer
Yes, and part of that is I think that we're going to continue to see significant growth in fee cash flow, so if the stock gets behind, we're using $23 million as a run rate. As we increase that run rate, we make acquisitions. If we don't see the stock price increase, at 10% the real run rate may be higher after we've done acquisitions and we haven't updated, so we may be in that 12% range when we're buying based on our $23 million run rate if the actual run rate is running closer to $24 million. Those are the kinds of things as the market fluctuates we'll be looking at and making analyses, kind of on the fly basis. Also, I mean, what acquisitions are out there and what kind of returns we can get on those acquisitions.

Q: Okay. A quick question on Bombshells. Eric, you briefly alluded to a price increase on some of your menu items on Bombshells. With some of the fast, casual restaurants seeing significant decline in their same-store sales, do you think it's the right time to implement a price increase?

Eric Langan – President and Chief Executive Officer
Well, I mean, basically we have no choice. Even those restaurants are increasing their prices because their food costs have gone up. Certain items, especially chicken wings and certain other items have gone up in cost. You have to increase your prices. You can't sell stuff at a loss. It has to fit our market and if we don't sell as much of a particular item because the cost is up, then hopefully people will move into our other items on our menu. There's a better price for them. We'll just have to see.

Our business has been very strong, and they're not significant price increases. It's percentage points to cover costs so I think we'll be fine with it. We'll know more as we move into the next few quarters, and if we start seeing issues, we'll worry about it at that point. At this point, I don't see it being a major issue. It's very non-specific entrée items that we raised. Most of our appetizers and desserts and all that stuff, most of that stuff stayed the same. So I'm not overly concerned with losing any business at this point.

Q: Okay. It's more of a function of food price than inflation, right?

Eric Langan – President and Chief Executive Officer
Yes, exactly. We weren't at the top of the chain either. We're not the most expensive dining out there right now either so we we're probably pretty middle-of-the-road. Other companies have raised their prices quicker than we have and so we basically, majorly our price increases are just catchups.

Q: Okay, got it. My last question is, are you currently looking at sizeable acquisitions, the size of Scarlett's Cabaret right now?

Eric Langan – President and Chief Executive Officer
There are multiple acquisition candidates out there right now, lots of people we're talking to in early stages. Obviously, we've put off a lot of the talks until we get the K caught up and get the Q out. We've told people that we'll call you back. We'll call you in March that we've talked to here in December and January. We'll call you back, we know you're interested, we have you on our list, and yes, we're interested, but the timing is a little off for us right now. We will get out there, and from all sizes. I mean, from very small acquisitions, strategic small acquisitions that meet our guidelines and meet the requirements for our capital allocation strategy, to very, very large acquisitions.

In fact, a couple of large multi-unit acquisitions that would actually be larger than a Scarlett's acquisition, so there's stuff out there. We just have to be careful and we want to make sure we have the right people. We do not want to put stress on our systems right now. We want to have a nice, smooth, steady—our growth for 2018 is already built in—so really what we're looking for is anything that's going to bring us in line for our 10% to 15% growth for 2019. Those are the things we're looking at, and like I said, we're not in a hurry. We're not going to rush but we are going to grow. I mean, you're going to see growth, and you will see us making acquisitions, probably in the near future.

Q: Yes, okay. Following from the acquisition front, you briefly mentioned that you're still open to making debt-fueled acquisitions. Are you still comfortable with your balance sheet with a debt of like almost $128 million right now?

Eric Langan – President and Chief Executive Officer
Sure. It's costing me less to service $128 million I have now than it was costing me to service $100 million I had before. I'll just refinance it all in 20-year terms. My debt has become more and more manageable. Even though the number went up, it's more and more manageable. It's all 20-year 5%, 5.25%, 5.75% debt. Before, I had 7-year terms on 12% debt and 11% debt. I have very few balloons in the next ten years now with what we've just done. I'm very, very comfortable with our debt.

Our debt is just our rent. We've always talked about, what you really have to do is look at our cost of occupancy. Maybe we need to get that back in some of these presentations and kind of discuss it a little bit again, but for the percentage of revenue, what is our rent and interest expense as a percentage of revenue, and that's our cost of occupancy, and I think we need to put it back in, and we'll look at it here in the Q, probably, and update that.

Now, we do have some development costs out there but as these new restaurants open—we're building three restaurants at one time right now, so there is several million dollars of real estate that we have and there's debt against that real estate, but as we open those restaurants, and that cash flow comes flowing in, it's going to look really, really good.

Q: Got it. Okay, Eric, last question. You laid out in your two to five-year strategy that you're looking to grow a free cash flow of 10% to 15%, and I know some of the other callers also mentioned it. Isn't that very conservative considering that your current—

Eric Langan – President and Chief Executive Officer
It can be as long as I'm finding the right acquisitions, yes, that's conservative. If my stock goes down, and I'm just buying back stock all of a sudden with my cash, 10% to 15% growth, a lot of stock I have to buyback, so the growth will be different. Yes, as we're in the acquisition and growth mode of the restaurants, it might be conservative, but at the same time, I'm not going to get crazy and say we have to go open six restaurants now because we want to do 22% growth, or I have to go buy something because now I want to do 22% or 25% growth.

I think we're just going to continue to do what we've been doing. It's been working very well for us over the last couple of years, the growth is solid, and I think we're getting close to a $160 million run rate for this year on total revenues without any acquisitions. If we make acquisitions, that number could increase. We're just going to take it quarter by quarter and watch and make sure we're on track.

Q: Alright. That's it from me. Thanks a lot, Eric. Congrats on a great quarter.

Operator
Our next question is with Ian McMillan, Private Investor. Please proceed with your question.

Q: Hi, Eric. I wanted to follow up with the guy from a couple questions ago, where he complimented you very much. I've been a shareholder for about eight years, and it never even crossed my mind to sell the stock, and I'm glad I've held on. With that in mind, I'm in Myrtle Beach, South Carolina, and we have a few club operators here, but we really could use a premium operator, so just take that as a hint.

Eric Langan – President and Chief Executive Officer
We've looked at that market. It's very seasonal. It's a tough, tough market. I don't know how those guys do it, when you're getting about six months, seven months out of the year, and the other five you're starving. We could have a look down there. We're bigger now. We probably could do a more seasonal type location. It's been a while since I've been in that market. I do like South Carolina, North Carolina. It is the East Coast type growth that we're looking for so, yes, we'll take a look, and see what's down there again. Like I said, it's been a long time.

Q: Thank you very much for that. You did lightly touch on possible wage pressures early on in your intro. We never really touched back on that when it comes to the employee wage pressures. I know there are a lot of gratuities that go on in the clubs, but how does Rick's or RCI actually take the wage pressures into account with the talent? How do they get paid, and how much are we actually talking here, $1, $2, $3? What's going on with the wage pressures?

Eric Langan – President and Chief Executive Officer
I mean, it just depends. I mean, at the club level, it's more we're worried about management. We are looking at something we call a longevity initiative, basically, is what I'm in the process of evaluating, where if you work for me, if you work at the club level as a bartender, if you get hired today or you've been there for ten years, pretty much your base pay is the same. We pay all bartenders a set minimum, we pay all wait staff a set minimum, we pay door staff a minimum, and very little fluctuation ever goes into that.

One of the things that we're exploring right now is it's like taking wait staff and saying okay, you get a tip credit wage of X if you've been here for one year when you first start. When you've been here for six months, we give you a base bump of X per hour, if you've been here for a year, you get a base bump. When you've been here for two years, when you've been here for five years, stuff like that, and trying to keep some of that longevity and not losing long-term employees and rewarding people for being with us and staying loyal to the company.

That's something we're currently in negotiations on amongst ourselves, amongst management, and doing some analysis on what we think the benefit will be versus what the cost will be and seeing if it makes sense if we start a program like that. That's one of the things we're talking about. Because we hate losing good employees to competitors for any reason and especially if our competitor is going to give them $0.50 more an hour or something like that. Why are we losing an employee?

Q: I agree 100%.

Eric Langan – President and Chief Executive Officer
Those are the kinds of things we're currently looking at, and a lot of it started with the tax cut act and saying look, we're going to have this extra cash. Other companies are starting to do these things. Maybe we should look at doing these things and how are we going to keep our management? How are we going to keep our top bar staff and our top waitresses? Now, they make tips and our clubs—in a lot of markets we're the number one clubs, but there are a lot of markets where we're not the number one club. We may be the number three club in that market,

and what are we doing to attract the best employees in that market and how are we working to become the number one club. Those are a lot of the questions that have been brought up at management level in the last, I'd say, two to three months, and we're working on that and hopefully, by this summer, I know a lot of stuff I keep pushing to the summer, but there's a lot of stuff we're working on.

We have to get the Q out. We finally got this K done. There's a little distraction with the financials, with the change to our new accounting system, moving to our new corporate office in the last year, but as these things are getting behind us, we are starting to look, and like I said, taking our capital allocation strategy to at every level of our business. If we invest at the employee level, what is our return of capital? Right? Those are hard questions to answer, but we're in the process of doing that, and we're in the process of saying, okay, are our top waitresses the ones that have been with us the longest or are they the newest ones? Are our top bartenders the ones that have been with us the longest as far as producing or are they the new ones, and kind of figuring out that balance and saying okay, what makes sense and what doesn't make sense?

We're in that process right now and I think we're going to really push through it here in I'd say the next 60 to 90 days and maybe we'll—it's not something we've really talked to about with our shareholders but it's something we've talked about internally—and maybe it's a conversation we need to get out there and get these back on and do some testing in certain markets. The tips go up and down by how many customers we put through the door and how the customers spend it. If our sales are up, you can bet our employees are getting more tips, and that's just the way the system works.

Our employees are very happy from the ones we've talked to or the majority. I mean, you can never keep all of the people happy all of the time but from the majority of the situations and from the clubs I've visited and the people I've talked to and the management that I've talked to, and the feedback I get online, overall, I think we're doing a really good job of keeping our employees happy.

I think, at our corporate level, we've had less and less turnover, especially since we've moved into the new office building, and we're getting a better-quality employee because our workspace environment is so much better than when we had 40 people working in 6,000 square feet. We're getting there.

Q: Well, Eric, let me tell you, personnel matters and so do CEOs and management, and I want to tell you you're doing a great job and I'm not selling my stock anytime soon, and I look forward to the next many years. Thank you, again.

Eric Langan – President and Chief Executive Officer
I really appreciate that. Thank you very much. You have a good one.

Operator
Are there any final questions? This is your last chance for questions, so if you do have one, please press star one on your telephone keypad. There seems to be no further questions, so I would like to give the call back to Gary Fishman for closing remarks.

Gary Fishman - Investor Relations
Thank you, Devon. In our deck today, we've included a couple supplemental slides in our appendix. Slide 15 is our calendar. A few things coming up, as Eric mentioned. In March, we celebrate the fifth anniversary of Bombshells. At the end of March, we're scheduled to present at the Sidoti Conference in New York City, and on April 10th we'll be reporting our second quarter club and restaurant sales.

I just wanted to make a note that Broward County is one of our big markets in Florida, and our hearts go out to those who were affected by what happened there today.

To conclude, on behalf of Eric, the company, the subsidiaries, everybody who works for the company, thank you and goodnight, and as always, please visit one of our clubs or restaurants.