

RCI HOSPITALITY HOLDINGS, INC.
Form 10-K
December 13, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended September 30, 2016

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number: 001-13992

RCI HOSPITALITY HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Texas

State or other jurisdiction of (I.R.S. Employer incorporation or organization Identification No.)

10737 Cutten Road, Houston, Texas 77066

(Address of principal executive offices)

(281) 397-6730

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$0.01 Par Value

(Title of class)

NASDAQ Stock Market LLC

Name of each exchange on which registered

Securities registered pursuant to section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes [] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes [] No [X]

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the registrant's most recently completed second fiscal quarter was \$80,889,036.

As of December 1, 2016, there were approximately 9,740,127 shares of common stock outstanding.

NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, among other things, statements regarding plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. Forward-looking statements may appear throughout this report, including without limitation, the following sections: Item 1 – “Business,” Item 1A – “Risk Factors,” and Item 7 – “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements generally can be identified by words such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “will be,” “will continue,” “likely result,” and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Annual Report on Form 10-K, and, in particular, the risks discussed under the caption “Risk Factors” in Item 1A and those discussed in other documents we file with the Securities and Exchange Commission (“SEC”). Important factors that in our view could cause material adverse effects on our financial condition and results of operations include, but are not limited to, the risks and uncertainties associated with operating and managing an adult business, the business climates in cities where it operates, the success or lack thereof in launching and building the company’s businesses, risks and uncertainties related to cyber security, conditions relevant to real estate transactions, and numerous other factors such as laws governing the operation of adult entertainment businesses, competition and dependence on key personnel. We undertake no obligation to revise or publicly release the results of any revision to any forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

TABLE OF CONTENTS

	Page No.
<u>PART I</u>	
Item 1. <u>Business</u>	4
Item 1A. <u>Risk Factors</u>	8
Item 1B. <u>Unresolved Staff Comments</u>	15
Item 2. <u>Properties</u>	15
Item 3. <u>Legal Proceedings</u>	16
Item 4. <u>Mine Safety Disclosures</u>	16
<u>PART II</u>	
Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases Of Equity Securities</u>	17
Item 6. <u>Selected Financial Data</u>	19
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	20
Item 7A. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	34
Item 8. <u>Financial Statements and Supplementary Data</u>	34
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosures</u>	71
Item 9A. <u>Controls and Procedures</u>	71
Item 9B. <u>Other Information</u>	71
<u>PART III</u>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	72
Item 11. <u>Executive Compensation</u>	75
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	80

Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	81
Item 14.	<u>Principal Accounting Fees and Services</u>	81
<u>PART IV</u>		
Item 15.	<u>Exhibits and Financial Statement Schedules</u>	82
	<u>Signatures</u>	83

PART I

Item 1. Business.

INTRODUCTION

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

Through our subsidiaries, as of November 30, 2016, we operated a total of 41 establishments that offer live adult entertainment, and/or restaurant and bar operations. We also operated a leading business communications company (the “Media Group”) serving the multi-billion-dollar adult nightclubs industry. We have two principal reportable segments: nightclubs and Bombshells restaurants and bars. In the context of club and restaurant/sports bar operations, the terms the “Company,” “we,” “our,” “us” and similar terms used in this Form 10-K refer to subsidiaries of RCIHH. Excepting executive officers of RCIHH, any employment referenced in this document is not with RCIHH but solely with one of its subsidiaries. RCIHH was incorporated in the State of Texas in 1994.

Our fiscal year ends on September 30. References to years 2016, 2015 and 2014 are for fiscal years ended September 30, 2016, 2015 and 2014, respectively. Our fiscal quarters chronologically end on December 31, March 31, June 30 and September 30.

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

OUR BUSINESS

We operate several businesses. We aggregate our businesses into two principal reportable segments – nightclubs and Bombshells restaurants/sports bars, and combine other operating segments into “Other” which primarily includes the

operations of our Media Group and Drink Robust.

Nightclubs

We operate our nightclubs through the following brands that target many different demographics of customers by providing a unique, quality entertainment environment:

“Rick’s Cabaret” – Elegant clubs with restaurants;

“Vivid Cabaret” – High-end high-energy club for young professionals;

“Tootsie’s Cabaret” – Nation’s largest mega club with 74,000 square feet;

“Club Onyx” – High-end clubs for African-American professionals;

“Jaguars Club” and “XTC Cabaret” – Lively BYOB clubs for blue collar patrons and the college crowd;

Other nightclub brands include “Hoops Cabaret,” “Downtown Cabaret,” “Temptations,” “Silver City Cabaret,” “Foxy’s Cabaret,” “Cabaret East,” and “The Seville.”

Our Company has received a significant amount of media exposure over the years in national magazines such as *Playboy*, *Penthouse*, *Glamour Magazine*, *The Ladies Home Journal*, *Time Magazine*, *Time Out New York*, and *Texas Monthly Magazine*. Segments about RCIHH have aired on national and local television programs such as “20/20,” “Extra” and “Inside Edition,” and we have provided entertainers for pay-per-view features as well. Business stories about RCI Hospitality Holdings, Inc. have appeared in *Forbes*, *Newsweek*, *The Wall Street Journal*, *The New York Times*, *The New York Post*, *Los Angeles Times*, *Houston Business Journal*, and numerous other national and regional publications. RCI Hospitality Holdings, Inc. has been profiled in *The Wall Street Journal*, *Fortune*, *MarketWatch*, *Corporate Board Member*, *Smart Money*, *USA Today*, *The New York Daily News* and other publications.

Refer to Item 2 – “Properties” for a listing of all our nightclubs and their locations.

Restaurants/Sports Bars

As of September 30, 2016, we operated four restaurants/sports bar as “Bombshells” in Dallas, Austin and Houston, Texas. In 2015, our subsidiary, BMB Franchising Services, Inc. (“BMB”), announced that it was beginning a nationwide franchising program for Bombshells. As of March 2016, BMB has received approval to sell franchises in all 50 states. The restaurant sets itself apart with décor that pays homage to all branches of the U.S. military. Locations feature local DJs, large outdoor patios, and more than 75 state of the art flat screen TVs for watching your favorite sports. All food and drink menu items have military names. Bombshell Girls, with their military-inspired uniforms, are a key attraction. Their mission, in addition to waitressing, is to interact with guests and generate a fun atmosphere.

We opened the first Bombshells in March 2013 in Dallas, quickly becoming one of the most popular restaurant destinations in the area. Within a year, four more opened in the Austin and Houston, Texas areas. Of the five, three are freestanding pad sites and two are inline locations. In September 2016, we closed one Bombshells location in Webster, Texas. In addition, we currently operate a bar in Fort Worth, Texas as Vee Lounge (reconcepted in October 2016 as Studio 80).

Media Group

The Media Group, made up of wholly owned subsidiaries, is the leading business communications company serving the multi-billion-dollar adult nightclubs industry. It owns a national industry convention and tradeshow; two national industry trade publications; two national industry award shows; and more than 25 industry websites. Included in the Media Group is ED Publications, publishers of the bimonthly ED Club Bulletin, the only national business magazine serving the 3,500-plus adult nightclubs in North America, which have annual revenues in excess of \$5 billion, according to the Association of Club Executives. ED Publications, founded in 1991, also publishes the Annual VIP Guide of adult nightclubs, touring entertainers and industry vendors; produces the Annual Gentlemen’s Club Owners

EXPO, a national convention and tradeshow; and offers the exclusive ED VIP Club Card, honored at more than 850 adult nightclubs. Also in the Media Group is Storerotica, founded in 2004, which publishes the bimonthly Storerotica Magazine, the industry trade publication for the multi-billion-dollar erotic apparel and adult novelty retail sales industries. The Media Group produces two nationally recognized industry award shows for the readers of both ED Club Bulletin and Storerotica magazines, and maintains a number of B-to-B and consumer websites for both industries.

Energy Drinks

In October 2014, we acquired 51% of a company with exclusive distribution rights to Robust brand energy drinks in North America. Robust targets the on-premises bar and mixer market in eight states. The company's exclusive rights are for 10 years, with rights to renew, with Sun Mark Limited of the UK, which has been manufacturing and distributing the drink under the Bullet brand there since 2008. Robust comes in standard 8.4-ounce energy drink cans and in four flavors: regular, sugar free, cranberry and lemon mint, which mixes particularly well with whiskey and tequila.

In September 2016, we sold a 31% interest in Robust to its former owner for a \$2.0 million note from him, retaining a 20% interest in the business. We recorded a \$641,000 gain on the sale, including deferred tax credits released on the sale of the business, and recognized an impairment charge of \$825,000 on the residual interest owned. Beginning as of the date of sale, we have begun to account for Robust as a cost method investment as we do not have significant influence.

OUR STRATEGY

Our overall objective is to create value for our shareholders by developing and operating profitable businesses in the hospitality and related space. We strive to achieve that by providing an attractive price-value entertainment and dining experience; by attracting and retaining quality personnel; and by focusing on unit-level operating performance. Aside from our operating strategy, we employ a capital allocation strategy.

Capital Allocation Strategy

Our capital allocation strategy provides us with disciplined guidelines on how we should use our free cash flows; provided, however, that we may deviate from this strategy if the circumstances warrant. We calculate free cash flow as net cash flows from operating activities minus maintenance capital expenditures. Using the after-tax yield of buying our own stock, or other strategic rationale in management's opinion, as baseline, we believe we are able to make better investment decisions.

Based on our capital allocation strategy:

We believe that buying back our own stock provides risk-free returns on our free cash flows since we are buying our own assets that we know very well;

We consider acquiring or developing our own clubs or restaurants that we believe have the potential to provide two times the after-tax yield of buying our own stock, absent an otherwise strategic rationale;

We consider paying down our debt when our stock price increases to a level where the after-tax yield of buying back our own stock is equal or lower than the after-tax yield of paying down our debt.

COMPETITION

The adult entertainment and the restaurant/sports bar businesses are highly competitive with respect to price, service and location. All of our nightclubs compete with a number of locally owned adult clubs, some of whose brands may have name recognition that equals that of ours. The names "Rick's" and "Rick's Cabaret," "Tootsie's Cabaret," "XTC Cabaret," "Silver City," "Club Onyx," "Downtown Cabaret," "Temptations," "The Seville," "Jaguars," "Hoops Cabaret," and "Foxy's C" are proprietary. In the restaurant/sports bar business, "Bombshells" is also proprietary. We believe that the combination of our existing brand name recognition and the distinctive entertainment environment that we have created will allow us to compete effectively in the industry and within the cities where we operate. Although we believe that we are well

positioned to compete successfully, there can be no assurance that we will be able to maintain our high level of name recognition and prestige within the marketplace.

GOVERNMENTAL REGULATIONS

We are subject to various federal, state and local laws affecting our business activities. Particularly in Texas, the authority to issue a permit to sell alcoholic beverages is governed by the Texas Alcoholic Beverage Commission (“TABC”), which has the authority, in its discretion, to issue the appropriate permits. We presently hold a Mixed Beverage Permit and a Late Hour Permit at numerous Texas locations. Minnesota, North Carolina, Indiana, Louisiana, Arizona, Pennsylvania, Florida, and New York have similar laws that may limit the availability of a permit to sell alcoholic beverages or that may provide for suspension or revocation of a permit to sell alcoholic beverages in certain circumstances. It is our policy, prior to expanding into any new market, to take steps to ensure compliance with all licensing and regulatory requirements for the sale of alcoholic beverages as well as the sale of food.

In addition to various regulatory requirements affecting the sale of alcoholic beverages, in many cities where we operate, the location of an adult entertainment cabaret is subject to restriction by city, county or other governmental ordinance. The prohibitions deal generally with distance from schools, churches, and other sexually oriented businesses and contain restrictions based on the percentage of residences within the immediate vicinity of the sexually oriented business. The granting of a sexually oriented business permit is not subject to discretion; the permit must be granted if the proposed operation satisfies the requirements of the ordinance. In all states where we operate, management believes we are in compliance with applicable city, county, state or other local laws governing the sale of alcohol and sexually oriented businesses.

TRADEMARKS

Our rights to the trade names “RCI Hospitality Holdings, Inc.,” “Rick’s,” “Rick’s Cabaret,” “Tootsie’s Cabaret,” “Club Onyx,” “XTC Cabaret,” “Temptations,” “Jaguars,” “Downtown Cabaret,” “Cabaret East,” “Bombshells Restaurant & Bar,” “Vee Lounge,” “The Seville Club,” “Down In Texas Saloon,” “Silver City Cabaret,” and “Exotic Dancer” are established under common law based upon our substantial and continuous use of these trade names in interstate commerce, some of which have been in use at least as early as 1987. We have registered our service mark, “RICK’S AND STARS DESIGN,” and the “BOMBSHELLS RESTAURANT & BAR” logo design with the United States Patent and Trademark Office. We have also obtained service mark registrations from the Patent and Trademark Office for the “RCI HOSPITALITY HOLDINGS, INC.,” “RICK’S,” “RICK’S CABARET,” “CLUB ONYX,” “XTC CABARET,” “SILVER CITY CABARET,” “BOMBSHELLS RESTAURANT & BAR,” “THE SEVILLE CLUB,” “DOWN IN TEXAS SALOON,” and “EXOTIC DANCER” service marks. As of this date, we have pending registration applications for the names “CLUB DULCE,” “FOXY’S CABARET,” and “HOOPS CABARET.” We also own the rights to numerous trade names associated with our media division. There can be no assurance that the steps we have taken to protect our service marks will be adequate to deter misappropriation.

EMPLOYEES AND INDEPENDENT CONTRACTORS

As of September 30, 2016, we had approximately 2,000 employees, of which approximately 160 are in management positions, including corporate and administrative operations, and approximately 1,840 are engaged in entertainment, food and beverage service, including bartenders, waitresses, and certain entertainers. None of our employees are represented by a union. We consider our employee relations to be good. Additionally, as of September 30, 2016, we had independent contractor entertainers, who are self-employed and conduct business at our locations on a non-exclusive basis. Our entertainers at Rick’s Cabaret in Minneapolis, Minnesota act as commissioned employees. Also, as of October 2016, our entertainers at Jaguars Club in Phoenix, Arizona are now classified as commissioned employees. All employees and independent contractors sign arbitration non-class action participation agreements.

We believe that the adult entertainment industry standard of treating entertainers as independent contractors provides us with safe harbor protection to preclude payroll tax assessment for prior years. We have prepared plans that we

believe will protect our profitability in the event that the sexually oriented business industry is required in all states to convert entertainers, who are now independent contractors, into employees. See related discussion in “Risk Factors.”

Item 1A. Risk Factors.

An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below before deciding to purchase shares of our common stock. If any of the events, contingencies, circumstances or conditions described in the risks below actually occurs, our business, financial condition or results of operations could be seriously harmed. The trading price of our common stock could, in turn, decline and you could lose all or part of your investment.

Our business operations are subject to regulatory uncertainties which may affect our ability to continue operations of existing nightclubs, acquire additional nightclubs, or be profitable.

Adult entertainment nightclubs are subject to local, state and federal regulations. Our business is regulated by local zoning, local and state liquor licensing, local ordinances, and state and federal time place and manner restrictions. The adult entertainment provided by our nightclubs has elements of speech and expression and, therefore, enjoys some protection under the First Amendment to the United States Constitution. However, the protection is limited to the expression, and not the conduct of an entertainer. While our nightclubs are generally well established in their respective markets, there can be no assurance that local, state and/or federal licensing and other regulations will permit our nightclubs to remain in operation or profitable in the future.

Our business has been, and may continue to be, adversely affected by conditions in the U.S. financial markets and economic conditions generally.

Our nightclubs are often acquired with a purchase price based on historical EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). This results in certain nightclubs carrying a substantial amount of intangible value, mostly allocated to licenses and goodwill. Generally accepted accounting principles require an annual impairment review of these indefinite-lived intangible assets. As a result of our annual impairment review, we recorded impairment charges of \$4.3 million (including \$1.4 million in one of our properties held for sale and \$825,000 relating to the remaining interest in Robust), \$1.7 million and \$2.3 million for fiscal 2016, 2015 and 2014, respectively. If difficult market and economic conditions continue over the next year and/or we experience a decrease in revenue at one or more nightclubs, we could incur a decline in fair value of one or more of our nightclubs. This could result in future impairment charges of up to the total value of the indefinite-lived intangible assets.

We may deviate from our present capital allocation strategy.

We believe that our present capital allocation strategy will provide us with optimized returns. However, implementation of our capital allocation strategy depends on the interplay of different factors such as our stock price, our outstanding common shares, the interest rates on our debt, and the rate of return on available investments. If these factors are not conducive to implementing our present capital allocation strategy, or we determine that adopting a different capital allocation strategy is in the best interest of shareholders, we reserve the right to deviate from this approach. There can be no assurance that we will not deviate from or adopt an alternative capital allocation strategy moving forward.

We may need additional financing or our business expansion plans may be significantly limited.

If cash generated from our operations is insufficient to satisfy our working capital and capital expenditure requirements, we will need to raise additional funds through the public or private sale of our equity or debt securities. The timing and amount of our capital requirements will depend on a number of factors, including cash flow and cash requirements for nightclub acquisitions and new restaurant development. If additional funds are raised through the issuance of equity or convertible debt securities, the percentage ownership of our then-existing shareholders will be reduced. We cannot assure you that additional financing will be available on terms favorable to us, if at all. Any future equity financing, if available, may result in dilution to existing shareholders; and debt financing, if available, may include restrictive covenants. Any failure by us to procure timely additional financing, if needed, will have material adverse consequences on our business operations.

There is substantial competition in the nightclub entertainment industry, which may affect our ability to operate profitably or acquire additional clubs.

Our nightclubs face substantial competition. Some of these competitors may have greater financial and management resources than we do. Additionally, the industry is subject to unpredictable competitive trends and competition for general entertainment dollars. There can be no assurance that we will be able to remain profitable in this competitive industry.

The adult entertainment industry standard is to classify adult entertainers as independent contractors, not employees. If federal or state law mandates that they be classified as employees, our business could be adversely impacted.

The adult entertainment industry standard is to classify adult entertainers as independent contractors, not employees. The Internal Revenue Service regulations and applicable state law guidelines regarding independent contractor classification are subject to judicial and agency interpretation, and it could be determined that the independent contractor classification is inapplicable. Further, if legal standards for classification of independent contractors change, it may be necessary to modify our compensation structure for these adult entertainers, including by paying additional compensation or reimbursing expenses. While we take steps to ensure that our adult entertainers are deemed independent contractors, if our adult entertainers are determined to have been misclassified as independent contractors, we would incur additional exposure under federal and state law, workers' compensation, unemployment benefits, labor, employment and tort laws, including for prior periods, as well as potential liability for employee benefits and tax withholdings. Any of these outcomes could result in substantial costs to us, could significantly impair our financial condition and our ability to conduct our business as we choose, and could damage our ability to attract and retain other personnel.

The adult entertainment industry is extremely volatile.

Historically, the adult entertainment, restaurant and bar industry has been an extremely volatile industry. The industry tends to be extremely sensitive to the general local economy, in that when economic conditions are prosperous, entertainment industry revenues increase, and when economic conditions are unfavorable, entertainment industry revenues decline. Coupled with this economic sensitivity are the trendy personal preferences of the customers who frequent adult cabarets. We continuously monitor trends in our customers' tastes and entertainment preferences so that, if necessary, we can make appropriate changes which will allow us to remain one of the premiere adult cabarets. However, any significant decline in general corporate conditions or uncertainties regarding future economic prospects that affect consumer spending could have a material adverse effect on our business. In addition, we have historically catered to a clientele base from the upper end of the market. Accordingly, further reductions in the amounts of entertainment expenses allowed as deductions from income under the Internal Revenue Code of 1954, as amended, could adversely affect sales to customers dependent upon corporate expense accounts.

Private advocacy group actions targeted at the kind of adult entertainment we offer could result in limitations and our inability to operate in certain locations and negatively impact our business.

Our ability to operate successfully depends on the protection provided to us under the First Amendment to the U.S. Constitution. From time to time, private advocacy groups have sought to target our nightclubs by petitioning for non-renewal of certain of our permits and licenses. Furthermore, private advocacy groups which have influences on certain financial institutions have managed to sway these financial institutions into not doing business with us. In addition to possibly limiting our operations and financing options, negative publicity campaigns, lawsuits and boycotts could negatively affect our businesses and cause additional financial harm by discouraging investors from investing in our securities or requiring that we incur significant expenditures to defend our business.

Our revenues could be significantly affected by limitations relating to permits to sell alcoholic beverages.

We derive a significant portion of our revenues from the sale of alcoholic beverages. States in which we operate may have laws which may limit the availability of a permit to sell alcoholic beverages or which may provide for suspension or revocation of a permit to sell alcoholic beverages in certain circumstances. The temporary or permanent suspension or revocations of any such permits would have a material adverse effect on our revenues, financial condition and results of operations. In all states where we operate, management believes we are in compliance with applicable city, county, state or other local laws governing the sale of alcohol.

Activities or conduct at our nightclubs may cause us to lose necessary business licenses, expose us to liability, or result in adverse publicity, which may increase our costs and divert management's attention from our business.

We are subject to risks associated with activities or conduct at our nightclubs that are illegal or violate the terms of necessary business licenses. Some of our nightclubs operate under licenses for sexually oriented businesses and are afforded some protection under the First Amendment to the U.S. Constitution. While we believe that the activities at our nightclubs comply with the terms of such licenses, and that the element of our business that constitutes an expression of free speech under the First Amendment to the U.S. Constitution is protected, activities and conduct at our nightclubs may be found to violate the terms of such licenses or be unprotected under the U.S. Constitution. This protection is limited to the expression and not the conduct of an entertainer. An issuing authority may suspend or terminate a license for a nightclub found to have violated the license terms. Illegal activities or conduct at any of our nightclubs may result in negative publicity or litigation. Such consequences may increase our cost of doing business, divert management's attention from our business and make an investment in our securities unattractive to current and potential investors, thereby lowering our profitability and our stock price.

We have developed comprehensive policies aimed at ensuring that the operation of each of our nightclubs is conducted in conformance with local, state and federal laws. We have a "no tolerance" policy on illegal drug use in or around the facilities. We continually monitor the actions of entertainers, waitresses and customers to ensure that proper behavior standards are met. However, such policies, no matter how well designed and enforced, can provide only reasonable, not absolute, assurance that the policies' objectives are being achieved. Because of the inherent limitations in all control systems and policies, there can be no assurance that our policies will prevent deliberate acts by persons attempting to violate or circumvent them. Notwithstanding the foregoing limitations, management believes that our policies are reasonably effective in achieving their purposes.

We rely heavily on information technology in our operations and any material failure, weakness, interruption or breach of security could prevent us from effectively operating our business.

Our operations and corporate functions rely heavily on information systems, including point-of-sale processing, management of our supply chain, payment of obligations, collection of cash, electronic communications, data warehousing to support analytics, finance and accounting systems, mobile technologies to enhance the customer experience, and other various processes and procedures, some of which are handled by third parties. Our ability to efficiently and effectively manage our business depends significantly on the reliability and capacity of these systems. The failure of these systems to operate effectively, maintenance problems, upgrading or transitioning to new platforms, or a breach in security relating to these systems could result in delays in consumer service and reduce efficiency in our operations. These problems could adversely affect our results of operations, and remediation could result in significant, unplanned capital investments.

Security breaches of confidential customer information or personal employee information may adversely affect our business.

A significant portion of our revenues are paid through debit and credit cards. Other restaurants and retailers have experienced significant security breaches in which debit and credit card information or other personal information of their customers have been stolen. We also maintain certain personal information regarding our employees. Although we aim to safeguard our technology systems, they could potentially be vulnerable to damage, disability or failures due to physical theft, fire, power outage, telecommunication failure or other catastrophic events, as well as from internal and external security breaches, employee error or malfeasance, denial of service attacks, viruses, worms and other disruptive problems caused by hackers and cyber criminals. A breach in our systems that compromises the information of our customers or employees could result in widespread negative publicity, damage to our reputation, a loss of customers, and legal liabilities. We may in the future become subject to lawsuits or other proceedings for purportedly fraudulent transactions arising from the actual or alleged theft of our customers' debit and credit card information or if customer or employee information is obtained by unauthorized persons or used inappropriately. Any such claim or proceeding, or any adverse publicity resulting from such an event, may have a material adverse effect on our business.

Our acquisitions may result in disruptions in our business and diversion of management's attention.

We have made and may continue to make acquisitions of complementary nightclubs, restaurants or related operations. Any acquisitions will require the integration of the operations, products and personnel of the acquired businesses and the training and motivation of these individuals. Such acquisitions may disrupt our operations and divert management's attention from day-to-day operations, which could impair our relationships with current employees, customers and partners. We may also incur debt or issue equity securities to pay for any future acquisitions. These issuances could be substantially dilutive to our stockholders. In addition, our profitability may suffer because of acquisition-related costs or amortization, or impairment costs for acquired goodwill and other intangible assets. If management is unable to fully integrate acquired business, products or persons with existing operations, we may not receive the benefits of the acquisitions, and our revenues and stock trading price may decrease.

The impact of new club or restaurant openings could result in fluctuations in our financial performance.

Performance of any new club or restaurant location will usually differ from its originally targeted performance due to a variety of factors, and these differences may be material. New clubs and restaurants typically encounter higher customer traffic and sales in their initial months, which may decrease over time. Accordingly, sales achieved by new or reconcepted locations may not be indicative of future operating results. Additionally, we incur substantial pre-opening expenses each time we open a new establishment, which expenses may be higher than anticipated. Due to the foregoing factors, results for any one fiscal quarter are not necessarily indicative of results to be expected for any other fiscal quarter or for a full fiscal year.

We must continue to meet NASDAQ Global Market Continued Listing Requirements or we risk delisting.

Our securities are currently listed for trading on the NASDAQ Global Market. We must continue to satisfy NASDAQ's continued listing requirements or risk delisting which would have an adverse effect on our business. If our securities are ever delisted from NASDAQ, they may trade on the over-the-counter market, which may be a less liquid market. In such case, our shareholders' ability to trade or obtain quotations of the market value of shares of our common stock would be severely limited because of lower trading volumes and transaction delays. These factors could contribute to lower prices and larger spreads in the bid and ask prices for our securities. There is no assurance that we will be able to maintain compliance with the NASDAQ continued listing requirements.

We incur significant costs as a result of operating as a public company, and our management devotes substantial time to new compliance initiatives.

We will incur significant legal, accounting and other expenses that our non-public competition does not incur. The Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”), as well as new rules subsequently implemented by the SEC, have imposed various requirements on public companies, including requiring certain corporate governance practices. Our management and other personnel devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations increase our legal and financial compliance costs, and will make some activities more time-consuming and costly.

In addition, the Sarbanes-Oxley Act requires, among other things, that we maintain effective internal controls for financial reporting and disclosure controls and procedures. In particular, we have been required to perform system and process evaluation and testing on the effectiveness of our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Then, beginning in fiscal 2010, our independent registered public accounting firm has reported on the effectiveness of our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. In the future, our testing, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses. Our compliance with Section 404 requires that we incur substantial accounting expense and expend significant management efforts. Moreover, if we are not able to comply with the requirements of Section 404 in a timely manner, or if we or our independent registered public accounting firm identifies deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline, and we could be subject to sanctions or investigations by the SEC or other regulatory authorities, which would require additional financial and management resources.

Our quarterly operating results may fluctuate and could fall below the expectations of securities analysts and investors due to seasonality and other factors, some of which are beyond our control, resulting in a decline in our stock price.

Our nightclub operations are affected by seasonal factors. Historically, we have experienced reduced revenues from April through September with the strongest operating results occurring during October through March. As a result, our quarterly and annual operating results and comparable restaurant sales may fluctuate significantly as a result of seasonality and the factors discussed above. Accordingly, results for any one fiscal quarter are not necessarily indicative of results to be expected for any other fiscal quarter or for any fiscal year and same-store sales for any particular future period may decrease. In the future, operating results may fall below the expectations of securities analysts and investors. In that event, the price of our common stock would likely decrease.

We may have uninsured risks in excess of our insurance coverage.

We maintain insurance in amounts we consider adequate for personal injury and property damage to which the business of the Company may be subject. However, there can be no assurance that uninsured liabilities in excess of the coverage provided by insurance, which liabilities may be imposed pursuant to the Texas “Dram Shop” statute or similar “Dram Shop” statutes or common law theories of liability in other states where we operate or expand. For example, the Texas “Dram Shop” statute provides a person injured by an intoxicated person the right to recover damages from an establishment that wrongfully served alcoholic beverages to such person if it was apparent to the server that the individual being sold, served or provided with an alcoholic beverage was obviously intoxicated to the extent that he presented a clear danger to himself and others. An employer is not liable for the actions of its employee who over-serves if (i) the employer requires its employees to attend a server training program approved by the TABC; (ii) the employee has actually attended such a training program; and (iii) the employer has not directly or indirectly encouraged the employee to violate the law. It is our policy to require that all servers of alcohol working at our clubs in Texas be certified as servers under a training program approved by the TABC, which certification gives statutory immunity to the sellers of alcohol from damage caused to third parties by those who have consumed alcoholic beverages at such establishment pursuant to the Texas Alcoholic Beverage Code. There can be no assurance, however, that uninsured liabilities may not arise in the markets in which we operate which could have a material adverse effect on the Company.

Our previous liability insurer may be unable to provide coverage to us and our subsidiaries.

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

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

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

The protection provided by our service marks is limited.

Our rights to the trade names “RCI Hospitality Holdings, Inc.,” “Rick’s,” “Rick’s Cabaret,” “Tootsie’s Cabaret,” “Club Onyx,” “XTC Cabaret,” “Temptations,” “Jaguars,” “Downtown Cabaret,” “Cabaret East,” “Cabaret North,” “Bombshells,” and “Vee Lou” are established under common law, based upon our substantial and continuous use of these trade names in interstate commerce, some of which have been in use at least as early as 1987. “RICK’S AND STARS DESIGN” logo, “RCI HOSPITALITY HOLDINGS, INC.,” “RICKS,” “RICK’S CABARET,” “CLUB ONYX,” “XTC CABARET,” “SILVER CITY CABARET,” “BOMBSHELLS” and “EXOTIC DANCER” are registered through service mark registrations issued by the United States Patent and Trademark Office. As of this date, we have pending registration applications for the names “THE SEVILLE” and “DOWN IN TEXAS SALOON.” We also own the rights to numerous trade names associated with our media division. There can be no assurance that these steps we have taken to protect our service marks will be adequate to deter misappropriation of our protected intellectual property rights. Litigation may be necessary in the future to protect our rights from infringement, which may be costly and time consuming. The loss of the intellectual property rights owned or claimed by us could have a material adverse effect on our business.

Anti-takeover effects of the issuance of our preferred stock could adversely affect our common stock.

Our Board of Directors has the authority to issue up to 1,000,000 shares of preferred stock in one or more series, to fix the number of shares constituting any such series, and to fix the rights and preferences of the shares constituting any series, without any further vote or action by the stockholders. The issuance of preferred stock by the Board of Directors could adversely affect the rights of the holders of our common stock. For example, such issuance could result in a class of securities outstanding that would have preferences with respect to voting rights and dividends and in liquidation over the common stock, and could (upon conversion or otherwise) enjoy all of the rights appurtenant to common stock. The Board’s authority to issue preferred stock could discourage potential takeover attempts and could delay or prevent a change in control of the Company through merger, tender offer, proxy contest or otherwise by making such attempts more difficult to achieve or costlier. There are no issued and outstanding shares of preferred

stock; there are no agreements or understandings for the issuance of preferred stock; and the Board of Directors has no present intention to issue preferred stock.

Future sales or the perception of future sales of a substantial amount of our common stock may depress our stock price.

The market price of our common stock could decline as a result of sales of substantial amounts of our common stock in the public market, or as a result of the perception that these sales could occur. In addition, these factors could make it more difficult for us to raise funds through future offerings of common stock.

Our stock price has been volatile and may fluctuate in the future.

The trading price of our securities may fluctuate significantly. This price may be influenced by many factors, including:

our performance and prospects;

the depth and liquidity of the market for our securities;

sales by selling shareholders of shares issued or issuable in connection with certain convertible notes;

investor perception of us and the industry in which we operate;

changes in earnings estimates or buy/sell recommendations by analysts;

general financial and other market conditions; and

domestic economic conditions.

Public stock markets have experienced, and may experience, extreme price and trading volume volatility. These broad market fluctuations may adversely affect the market price of our securities.

We are dependent on key personnel.

Our future success is dependent, in a large part, on retaining the services of Mr. Eric Langan, our President and Chief Executive Officer. Mr. Langan possesses a unique and comprehensive knowledge of our industry. While Mr. Langan has no present plans to leave or retire in the near future, his loss could have a negative effect on our operating, marketing and financial performance if we are unable to find an adequate replacement with similar knowledge and experience within our industry. We maintain key-man life insurance with respect to Mr. Langan. Although Mr. Langan is under an employment agreement (as described herein), there can be no assurance that Mr. Langan will continue to be employed by us.

Cumulative voting is not available to our stockholders.

Cumulative voting in the election of Directors is expressly denied in our Articles of Incorporation. Accordingly, the holder or holders of a majority of the outstanding shares of our common stock may elect all of our Directors.

Our directors and officers have limited liability and have rights to indemnification.

Our Articles of Incorporation and Bylaws provide, as permitted by governing Texas law, that our directors and officers shall not be personally liable to us or any of our stockholders for monetary damages for breach of fiduciary duty as a director or officer, with certain exceptions. The Articles further provide that we will indemnify our directors and officers against expenses and liabilities they incur to defend, settle, or satisfy any civil litigation or criminal action brought against them on account of their being or having been its directors or officers unless, in such action, they are adjudged to have acted with gross negligence or willful misconduct.

The inclusion of these provisions in the Articles may have the effect of reducing the likelihood of derivative litigation against directors and officers, and may discourage or deter stockholders or management from bringing a lawsuit against directors and officers for breach of their duty of care, even though such an action, if successful, might otherwise have benefited us and our stockholders.

The Articles provide for the indemnification of our officers and directors, and the advancement to them of expenses in connection with any proceedings and claims, to the fullest extent permitted by Texas law. The Articles include related provisions meant to facilitate the indemnitee's receipt of such benefits. These provisions cover, among other things: (i) specification of the method of determining entitlement to indemnification and the selection of independent counsel that will in some cases make such determination, (ii) specification of certain time periods by which certain payments or determinations must be made and actions must be taken, and (iii) the establishment of certain presumptions in favor of an indemnitee.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers and controlling persons pursuant to the foregoing provisions, we have been advised that in the opinion of the Securities and Exchange Commission, such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

A failure to maintain food safety throughout the supply chain and food-borne illness concerns may have an adverse effect on our business.

Food safety is a top priority, and we dedicate substantial resources to ensuring that our guests enjoy safe, quality food products. However, food safety issues could be caused at the point of source or by food suppliers or distributors and, as a result, be out of our control. In addition, regardless of the source or cause, any report of food-borne illnesses such as E. coli, hepatitis A, trichinosis or salmonella, and other food safety issues including food tampering or contamination, at one of our restaurants or clubs could adversely affect the reputation of our brands and have a negative impact on our sales. Even instances of food-borne illness, food tampering or food contamination occurring solely at restaurants of our competitors could result in negative publicity about the food service industry generally and adversely impact our sales. The occurrence of food-borne illnesses or food safety issues could also adversely affect the price and availability of affected ingredients, resulting in higher costs and lower margins.

Other risk factors may adversely affect our financial performance.

Other risk factors that could cause our actual results to differ materially from those indicated in the forward-looking statements by affecting, among many things, pricing, consumer spending and consumer confidence, include, without limitation, changes in economic conditions and financial and credit markets, credit availability, increased fuel costs and availability for our employees, customers and suppliers, health epidemics or pandemics or the prospects of these events (such as reports on avian flu), consumer perceptions of food safety, changes in consumer tastes and behaviors, governmental monetary policies, changes in demographic trends, terrorist acts, energy shortages and rolling blackouts, and weather (including, major hurricanes and regional snow storms) and other acts of God.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

We currently own 45 real estate properties. On 30 of these properties, we operate clubs or restaurants, including a multi-unit shopping center in Miami Gardens, Florida where Tootsie's Cabaret is located. We lease other units in our Miami Gardens property to 14 different third-party tenants. Our remaining clubs and restaurants are in leased locations.

Three of our owned properties are locations where we previously operated clubs but now lease the buildings to third parties. Four are non-income producing properties for corporate use, including our corporate office. Six other properties are currently offered for sale, while the remaining two properties are large parcels, which we plan to further subdivide for a future Bombshells site and for sale.

Our principal corporate office as of September 30, 2016 was located at 10959 Cutten Road, Houston, Texas 77066, which consisted of a 9,000 square foot office/warehouse building. That corporate office was no longer adequate to meet our needs so we have constructed a new corporate facility on a nearby tract of land, which we own. The new corporate facility, which is located at 10737 Cutten Road, Houston, Texas 77066, consists of a 21,000-square foot corporate office and an 18,000-square foot warehouse facility. We completed our move to the new corporate facility in October 2016.

Below is a list of locations we operate:

Name of Establishment	Year Acquired/Opened
Club Onyx, Houston, TX	1995
Rick's Cabaret, Minneapolis, MN	1998
XTC Cabaret, Austin, TX	1998
XTC Cabaret, San Antonio, TX	1998
XTC Cabaret, Houston, TX	2004 (2)
Rick's Cabaret, New York City, NY	2005
Club Onyx, Charlotte, NC	2005 (2)
Rick's Cabaret, San Antonio, TX	2006
XTC Cabaret, South Houston, TX	2006 (2)
Rick's Cabaret, Fort Worth, TX	2007
Tootsie's Cabaret, Miami Gardens, FL	2008
XTC Cabaret, Dallas, TX	2008
Foxy's Cabaret, Dallas, TX	2008 (1)
Club Onyx, Philadelphia, PA	2008
Rick's Cabaret, Round Rock, TX	2009
Cabaret East, Fort Worth, TX	2010
Rick's Cabaret DFW, Fort Worth, TX	2011
Downtown Cabaret, Minneapolis, MN	2011
Temptations, Aledo, TX	2011 (2)
Silver City Cabaret, Dallas, TX	2012
Jaguars Club, Odessa, TX	2012
Jaguars Club, Phoenix, AZ	2012
Jaguars Club, Lubbock, TX	2012
Jaguars Club, Longview, TX	2012
Jaguars Club, Tye, TX	2012
Jaguars Club, Edinburg, TX	2012
Jaguars Club, El Paso, TX	2012
Jaguars Club, Harlingen, TX	2012
Studio 80, Fort Worth, TX	2013 (1)(2)
Bombshells, Dallas, TX	2013
Temptations, Sulphur, LA	2013
Temptations, Beaumont, TX	2013
Club Onyx, Dallas, TX	2013 (1)
Vivid Cabaret, New York, NY	2014 (2)
Bombshells, Austin, TX	2014 (2)
Rick's Cabaret, Odessa, TX	2014
Bombshells, Spring TX	2014 (2)
Bombshells, Houston, TX	2014 (2)
Foxy's Cabaret, Austin TX	2015 (1)
The Seville, Minneapolis, MN	2015
Hoops Cabaret and Sports Bar, New York, NY	2016 (2)(3)

- (1) Reconcepted in 2016.
- (2) Leased location.
- (3) Officially opened on October 6, 2016.

Our property leases are typically for a fixed rental rate without revenue percentage rentals. The lease terms generally have initial terms of 10 to 20 years with renewal terms of 5 to 20 years. At September 30, 2016, certain of our owned properties were collateral for mortgage debt amounting to approximately \$76.2 million. Also, see more information in the following Notes to Consolidated Financial Statements: F - Property and Equipment, H - Long-Term Debt and K - Commitments and Contingencies.

Item 3. Legal Proceedings.

See the “Legal Matters” section within Note K - Commitments and Contingencies of Notes to Consolidated Financial Statements within this Annual Report on Form 10-K for the requirements of this Item, which section is incorporated herein by reference.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is quoted on the NASDAQ Global Market under the symbol “RICK.” The following table sets forth the quarterly high and low of sales prices per share for the common stock for the last two fiscal years.

COMMON STOCK PRICE RANGE	High	Low
Fiscal Year Ended September 30, 2016		
First Quarter	\$ 10.75	\$ 9.38
Second Quarter	\$ 9.94	\$ 7.50
Third Quarter	\$ 11.10	\$ 8.77
Fourth Quarter	\$ 11.60	\$ 9.90
Fiscal Year Ended September 30, 2015		
First Quarter	\$ 12.25	\$ 9.13
Second Quarter	\$ 11.04	\$ 9.57
Third Quarter	\$ 12.50	\$ 10.30
Fourth Quarter	\$ 12.14	\$ 10.25

On December 8, 2016, the closing stock price for our common stock as reported by NASDAQ was \$14.38. On December 1, 2016, there were approximately 177 stockholders of record of our common stock (excluding broker held shares in street name). We estimate that there are approximately 5,100 stockholders to have beneficial ownership in street name.

TRANSFER AGENT AND REGISTRAR

The transfer agent and registrar for our common stock is American Stock Transfer & Trust Company, 6201 15th Avenue, Brooklyn, NY 11219.

DIVIDEND POLICY

Prior to 2016, we have not paid cash dividends on our common stock. Starting in March 2016, in conjunction with our share buyback program (see discussion below), our Board of Directors has declared quarterly cash dividends of \$0.03 per share (\$0.12 per share on an annual basis). During fiscal 2016, we paid an aggregate amount of \$862,000 for cash dividends.

PURCHASES OF EQUITY SECURITIES BY THE ISSUER

During the fiscal year ended September 30, 2016, we purchased a total of 747,081 shares of common stock in the open market at prices ranging from \$7.69 to \$11.55. In May 2016, the Board of Directors increased the repurchase authorization by an additional \$5.0 million.

The table below sets forth information regarding our common stock repurchases during the three months ended September 30, 2016:

Month Ended	Total Number of Shares (or Units) Purchased	Average Price Paid per Share	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Yet be Purchased Under the Plans or Programs
July 31, 2016	41,486	\$ 10.38	41,486	\$ 5,341,543
August 31, 2016	46,200	\$ 10.82	46,200	\$ 4,841,459
September 30, 2016	52,400	\$ 11.44	52,400	\$ 4,242,209

EQUITY COMPENSATION PLAN INFORMATION

We have no stock options nor any other equity award outstanding under equity compensation plans as of September 30, 2016.

STOCK PERFORMANCE GRAPH

The following chart compares the 5-year cumulative total stock performance of our common stock; the NASDAQ Composite Index; our former peer group consisting of BJ's Restaurant Group, Cheesecake Factory, Ark Restaurants and Buffalo Wild Wings; and the Dow Jones U.S. Restaurant & Bar Index, our current peer index. The graph assumes that \$100 was invested at inception in each of our common stock and in each of the indices and that all dividends were reinvested. The measurement points utilized in the graph consist of the last trading day as of September 30 each year, representing the last day of our fiscal year. The calculations exclude trading commissions and taxes. We have selected the Dow Jones U.S. Restaurant & Bar Index as our new peer index since it represents a broader group of restaurant and bar operators than our former four-company peer group, both of which are shown below for comparison. The historical stock performance presented below is not intended to and may not be indicative of future stock performance.

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

Long-term debt (including current portion)(2)	\$105,886	\$94,349	\$70,092	\$78,352	\$63,447
Total liabilities(2)	\$146,346	\$138,313	\$120,205	\$121,127	\$100,990
Total RCIHH stockholders' equity	\$127,558	\$122,623	\$110,289	\$93,781	\$84,306

Due to a change in accounting policy, we have reported revenues net of sales taxes and other revenue related taxes (1) since the beginning of fiscal 2016. Prior year revenues and expenses have been revised to reflect this change. Refer to Note B to the consolidated financial statements for further discussion.

Certain items in the prior year financial statements have been reclassified to conform to current year financial statement presentation, in particular, debt issuance costs as prescribed by ASU 2015-03 and deferred tax assets (2) and liabilities as prescribed by ASU 2015-17. Refer to Note B to the consolidated financial statements for further discussion.

Reconciliation and discussion of non-GAAP financial measures are included under the “Non-GAAP Financial (3) Measures” section of Item 7 – “Management’s Discussion and Analysis of Financial Condition and Results of Operations” that follows. See also notes on comparability of adjustment items at the end of the section.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

OVERVIEW

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) is intended to help the reader understand RCI Hospitality Holdings, Inc., our operations and our present business environment. MD&A is provided as a supplement to — and should be read in conjunction with — our consolidated financial statements and the accompanying notes thereto contained in Item 8 – “Financial Statements and Supplementary Data” of this report. This overview summarizes the MD&A, which includes the following sections:

Our Business — a general description of our business and the adult nightclub industry, our objective, our strategic priorities, our core capabilities, and challenges and risks of our business.

Critical Accounting Policies and Estimates — a discussion of accounting policies that require critical judgments and estimates.

Operations Review — an analysis of our Company’s consolidated results of operations for the three years presented in our consolidated financial statements.

Liquidity and Capital Resources — an analysis of cash flows, aggregate contractual obligations, and an overview of financial position.

OUR BUSINESS

The following are our operating segments:

Nightclubs	Our wholly owned subsidiaries own and/or operate upscale adult nightclubs serving primarily businessmen and professionals. These nightclubs are in Houston, Austin, San Antonio, Dallas, Fort Worth, Beaumont, Longview, Harlingen, Edinburg, Tye, Lubbock, El Paso and Odessa, Texas; Charlotte, North Carolina; Minneapolis, Minnesota; New York, New York; Miami Gardens, Florida; Philadelphia, Pennsylvania; and Phoenix, Arizona. No sexual contact is permitted at any of our locations.
Bombshells Restaurants and Sports Bars	Our wholly owned subsidiaries own and operate non-adult nightclubs, restaurants, and sports bars in Houston, Dallas, Austin, Spring, and Fort Worth, Texas under the brand names Bombshells and Vee Lounge (reconcepted in October 2016 as Studio 80).

Media Group Our wholly owned subsidiaries own a media division, including the leading trade magazine serving the multi-billion-dollar adult nightclubs industry. We also own an industry trade show, one other industry trade publications and more than 15 industry websites.

Our revenues are derived from the sale of liquor, beer, wine, food, merchandise, cover charges, membership fees, facility use fees, commissions from vending and ATM machines, valet parking and other products and services for both nightclub and restaurant/sports bar operations. Media Group revenues include the sale of advertising content and revenues from our annual Expo convention. Our fiscal year end is September 30.

We calculate same-store sales by comparing year-over-year revenues from nightclubs and restaurants/sports bars operating at least 12 full months. We exclude from a particular month's calculation units previously included in the same-store sales base that have closed temporarily for more than 15 days until its next full month of operations. We also exclude from the same-store sales base units that are being reconcepted or are closed due to renovations or remodels. Acquired units are included in the same-store sales calculation as long as they qualify based on the definition stated above. Revenues from non-nightclub and non-restaurant/sports bar operations are excluded from same-store sales calculation.

Our goal is to use our Company's assets — our brands, financial strength, and the talent and strong commitment of our management and associates — to become more competitive and to accelerate growth in a manner that creates value for our shareholders.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of these consolidated financial statements requires our management to make assumptions and estimates about future events, and apply judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. These estimates are based on management's historical industry experience and on various other assumptions that are believed to be reasonable under the circumstances. On a regular basis, we evaluate these accounting policies, assumptions, estimates and judgments to ensure that our financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results may differ from our estimates, and such differences could be material.

A full discussion of our significant accounting policies is contained in Note B – Summary of Significant Accounting Policies, which is included in Item 8 – “Financial Statements and Supplementary Data” of this report. We believe that the following accounting estimates are the most critical to aid in fully understanding and evaluating our financial results. These estimates require our most difficult, subjective or complex judgments because they relate to matters that are inherently uncertain. We have reviewed these critical accounting policies and estimates and related disclosures with our Audit Committee.

Impairment of Long-Lived Assets

We review long-lived assets, such as property and equipment, and purchased intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. We impaired one property held for sale by \$1.4 million based on estimated realizable value less costs to sell.

Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount of the reporting unit exceeds its fair value.

Our impairment calculations require management to make assumptions and to apply judgment in order to estimate fair values. If our actual results are not consistent with our estimates and assumptions, we may be exposed to impairments that could be material. We do not believe that there is a reasonable likelihood that there will be a material change in the estimates or assumptions we used to calculate impairment charges.

To begin the review, we determine the cash flows from each unit and compare these to prior periods along with comparisons of gross margin and same store sales comparisons. For any of these units that we believe require further analysis as a result of the comparisons made, we prepare an estimated discounted future cash flows expected to be generated by the asset to determine the estimated fair value of the unit. This is compared to the carrying value of the unit and reviewed for reasonableness. If necessary, an impairment charge is recognized by the amount by which the carrying amount of any unit exceeds the fair value of the assets. For the year ended September 30, 2016, we impaired one unit in this manner in the amount of \$2.1 million. There were no other units in which the estimated fair value was not substantially in excess of the carrying value.

Income Taxes

We estimate certain components of our provision for income taxes. These estimates include depreciation and amortization expense allowable for tax purposes, allowable tax credits for items such as taxes paid on employee tip income, effective rates for state and local income taxes, and the deductibility of certain other items, among others. We adjust our annual effective income tax rate as additional information on outcomes or events becomes available.

Legal and Other Contingencies

As mentioned in Item 3 – “Legal Proceedings” and in a more detailed discussion in Note K to our consolidated financial statements, we are involved in various suits and claims in the normal course of business. We record a liability when it is probable that a loss has been incurred and the amount is reasonably estimable. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In the opinion of management, there was not at least a reasonable possibility that we may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for asserted legal and other claims. However, the outcome of legal proceedings and claims brought against the Company is subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a reporting period for amounts in excess of management’s expectations, the Company’s consolidated financial statements for that reporting period could be materially adversely affected.

OPERATIONS REVIEW

The following tables presents a comparison of our results of operations as a percentage of total revenues for the past three fiscal years:

	2016	2015	2014
Sales of alcoholic beverages	42.4 %	41.2 %	39.4 %
Sales of food and merchandise	13.3 %	13.8 %	12.1 %
Service revenues	38.0 %	39.1 %	42.8 %
Other	6.3 %	5.8 %	5.7 %
Total revenues	100.0%	100.0%	100.0%
Cost of goods sold	15.2 %	15.0 %	13.5 %
Salaries and wages	27.8 %	27.9 %	26.8 %
Selling, general and administrative	31.9 %	32.2 %	33.8 %
Depreciation and amortization	5.3 %	5.1 %	5.2 %
Other charges	4.3 %	4.5 %	5.2 %
Total operating expenses	84.5 %	84.6 %	84.5 %
Income from operations	15.5 %	15.4 %	15.5 %
Interest expense	-5.9 %	-5.1 %	-6.4 %
Interest income	0.1 %	0.0 %	0.1 %
Non-operating gains	0.0 %	0.2 %	4.6 %
Income before income taxes	9.6 %	10.4 %	13.9 %
Income taxes	2.0 %	3.8 %	4.9 %
Net income	7.7 %	6.6 %	9.1 %

* Percentages may not foot due to rounding.

Below is a table presenting the changes in each line item of the income statement for the last three fiscal years (dollar amounts in thousands)

	Increase (Decrease)			
	2016 vs. 2015		2015 vs. 2014	
	Amount	%	Amount	%
Sales of alcoholic beverages	\$1,387	2.5 %	\$7,936	16.6 %
Sales of food and merchandise	(813)	-4.3 %	4,044	27.6 %
Service revenues	(1,738)	-3.3 %	1,042	2.0 %
Other	575	7.3 %	995	14.4 %
Total revenues	(589)	-0.4 %	14,017	11.5 %
Cost of goods sold	229	1.1 %	3,891	23.7 %
Salaries and wages	(275)	-0.7 %	5,175	15.9 %
Selling, general and administrative	(523)	-1.2 %	2,609	6.4 %
Depreciation and amortization	279	4.0 %	578	9.2 %
Other charges, net	(269)	-4.5 %	(239)	-3.8 %
Total operating expenses	(559)	-0.5 %	12,014	11.7 %
Income from operations	(30)	-0.1 %	2,003	10.6 %
Interest expense	(1,013)	14.5 %	783	-10.1 %
Interest income	116	773.3 %	(133)	-89.9 %
Non-operating gains	(229)	-100.0 %	(5,413)	-95.9 %
Income before income taxes	(1,156)	-8.2 %	(2,760)	-16.3 %
Income taxes	(2,507)	-48.5 %	(752)	-12.7 %
Net income	\$1,351	15.0 %	\$(2,008)	-18.3 %

Revenues

Our total consolidated revenues for fiscal 2016 amounted to \$134.9 million compared to \$135.4 million for fiscal 2015 and \$121.4 million for fiscal 2014. The \$0.6 million, or 0.4%, decrease from 2015 to 2016 was primarily due to a 1.3% decrease in same-store sales partially offset by an increase in rental income and sale of energy drinks. The \$14.0 million, or 11.5%, increase from 2014 to 2015 was primarily due to revenues generated in our new units opened or acquired in 2015, a full year of revenues from units opened or purchased in 2014 and increases in revenues from certain of our existing units, especially from our Temptations Beaumont, Onyx Houston and Bombshells Dallas locations. Revenues from nightclub and restaurant/sports bar operations for same-location same-period decreased by 1.3% in 2016 and 0.6% in 2015, and increased by 4.5% in 2014.

By reportable segment, revenues were as follows (in thousands):

	2016	2015	2014
Business segment revenues:			
Nightclubs	\$113,941	\$115,493	\$114,157
Bombshells	18,690	17,639	5,768
Other	2,229	2,317	1,507
	\$134,860	\$135,449	\$121,432

Operating Costs and Expenses

Cost of goods sold includes cost of alcoholic and non-alcoholic beverages, food, cigars and cigarettes, merchandise, media printing/binding and media. As a percentage of revenues, 2016 cost of goods sold was flat at 15.2% compared to 2015 at 15.0%, while 2015 had a substantial increase versus 2014 at 13.5%. The increase percentage in 2015 was mainly due to higher cost of goods sold for new Bombshells opened.

The increase in salaries and wages from 2014 to 2015 was primarily driven by higher unit count. The decrease in salaries and wages from 2015 to 2016 was primarily due to closures of club or restaurant units, whether permanently or temporarily for remodel or reconcepting.

The components of selling, general and administrative expenses are in the tables below (dollars in thousands):

	Years Ended September 30,			Percentage of Revenues		
	2016	2015	2014	2016	2015	2014
Taxes and permits	\$8,089	\$8,031	\$8,222	6.0 %	5.9 %	6.8 %
Advertising and marketing	5,374	5,610	5,578	4.0 %	4.1 %	4.6 %
Supplies	4,815	4,726	4,023	3.6 %	3.5 %	3.3 %
Legal and professional	4,483	4,581	3,416	3.3 %	3.4 %	2.8 %
Insurance	3,575	3,364	3,994	2.7 %	2.5 %	3.3 %
Rent	3,278	4,526	4,804	2.4 %	3.3 %	4.0 %
Utilities	2,871	2,999	2,684	2.1 %	2.2 %	2.2 %
Charge cards fees	2,252	2,176	1,790	1.7 %	1.6 %	1.5 %
Security	2,042	1,905	1,641	1.5 %	1.4 %	1.4 %
Repairs and maintenance	2,088	1,916	1,719	1.5 %	1.4 %	1.4 %
Other	4,208	3,764	3,118	3.1 %	2.8 %	2.6 %
	\$43,075	\$43,598	\$40,989	31.9%	32.2%	33.8%

The significant variances in selling, general and administrative expenses are as follows:

The decrease in the percentage of rent expense to revenues is principally due to the sale/closure of certain clubs in 2014, and the acquisition of the New York property in 2015 through 2016.

Legal and professional expenses increased by \$1.2 million in 2015 compared to 2014 principally due to increased activity and settlement in the New York labor lawsuit.

The decrease in insurance expense is principally due to a general liability insurance premium decrease in 2015 compared to 2014.

We consider rent plus interest expense as our occupancy costs since most of our debt are for real property where our clubs and restaurants are located. As a percentage of revenues, rent has consistently dropped as we bought properties and interest expense has increased, but in total, occupancy costs have gone down.

	2016	2015	2014
Rent	2.4 %	3.3 %	4.0 %
Interest	5.9 %	5.1 %	6.4 %
Total occupancy cost	8.3 %	8.5 %	10.3 %

Depreciation and amortization slightly increased consistent with the higher long-lived asset base.

The components of other charges, net are in the tables below (dollars in thousands):

	Years Ended September			Percentage of		
	2016	2015	2014	2016	2015	2014
Impairment of assets	\$4,317	\$1,705	\$2,294	3.2 %	1.3 %	1.9 %
Settlement of lawsuits and other one-time costs	1,881	11,684	3,696	1.4 %	8.6 %	3.0 %
Loss (gain) on sale of assets	(437)	808	279	-0.3 %	0.6 %	0.2 %
Gain on settlement of patron tax	-	(8,167)	-	0.0 %	-6.0 %	0.0 %
Total other charges, net	\$5,761	\$6,030	\$6,269	4.3 %	4.5 %	5.2 %

The significant variances in other charges, net are as follows:

See Note P - Impairment of Assets of Notes to Consolidated Financial Statements for an explanation of the impairment of assets.

Settlement of lawsuits and other one-time costs in 2015 consists principally of settlement of suits relating to the New York based federal wage and hour class and collective action, as explained in Note K - Commitments and Contingencies of Notes to Consolidated Financial Statements.

See Note N – Acquisitions and Dispositions of Notes to Consolidated Financial Statements for an explanation of the gain/loss on sale of assets, particularly relating to the sale of our controlling interest in Robust in 2016.

See Note K - Commitments and Contingencies of Notes to Consolidated Financial Statements for an explanation of the gain on settlement of patron tax in 2015.

Income from Operations

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

Our operating margin (income from operations divided by total revenues) was 15.5% in 2016, 15.4% in 2015 and 15.5% in 2014. The main drivers of the net change in the components of operating margin are the increase in the number of Bombshells, the settlement of the New York lawsuit in 2015, and the gain on settlement of patron tax in 2015.

Below is a table which reflects segment contribution to income from operations (in thousands):

	2016	2015	2014
Business segment operating income (loss):			
Nightclubs	\$33,227	\$30,444	\$25,970
Bombshells	1,291	1,773	(315)
Other	(2,650)	(1,921)	(246)
General corporate	(11,020)	(9,418)	(6,534)
	\$20,848	\$20,878	\$18,875

Excluding the impact of other charges attributable to specific segments, operating margin for the Nightclub segment was 32.3%, 30.9% and 28.0% for 2016, 2015 and 2014, respectively, while the Bombshells segment was 14.3%, 14.6% and (5.5%) for 2016, 2015 and 2014, respectively.

Non-Operating Items

See Note Q - Gain on Contractual Debt Reduction of Notes to Consolidated Financial Statements, for an explanation of the \$5.6 million contractual debt reduction item in fiscal 2014.

Interest expense decreased in 2015 due to the significant paydown and refinance of high-interest debt during the last two years. We are now able to finance property acquisition with bank debt which is at significantly lower rates than the debt we previously had. We added more debt in 2016 to acquire certain properties, which in turn increased our interest expense and also decreased rent expense.

Income Taxes

Income tax expense decreased by \$2.5 million from 2015 to 2016 and by \$0.8 million from 2014 to 2015. Our effective income tax rate was 20.4%, 36.5% and 35.0% during fiscal 2016, 2015 and 2014, respectively. The difference in our annual effective income tax rate was primarily due to the impact of tax credit carryforwards and the transfer of deferred tax liabilities related to sold subsidiaries, offset by state income taxes in 2016; and the impact of stock-based compensation and other permanent differences in 2015.

Non-GAAP Financial Measures

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

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

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

Adjusted EBITDA. We exclude from adjusted EBITDA depreciation expense, amortization of intangibles, income tax, interest expense, interest income, gains and losses from asset sales, litigation and other one-time legal settlements, gain on settlement of patron tax case, gain on acquisition/loss on disposition of controlling interest in subsidiary, gain on contractual debt reduction and impairment charges because we believe that adjusting for such items helps management and investors better understand operating activities. Adjusted EBITDA provides a core operational performance measurement that compares results without the need to adjust for federal, state and local taxes which have considerable variation between domestic jurisdictions. The results are, therefore, without consideration of financing alternatives of capital employed. We use adjusted EBITDA as one guideline to assess our unleveraged performance return on our investments. Adjusted EBITDA is also the target benchmark for our acquisitions of nightclubs.

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

The following tables present our non-GAAP performance measures for the periods indicated (in thousands, except per share amounts and percentages):

	For the Year Ended September 30,		
	2016	2015	2014
Reconciliation of GAAP net income to Adjusted EBITDA			
GAAP net income	\$ 11,089	\$ 9,312	\$ 11,240
Income tax expense	2,657	5,164	5,916
Interest expense and income	7,851	6,954	7,604
Litigation and other one-time settlements	1,881	11,684	3,696
Gain on settlement of patron tax case	-	(8,167)	-
Impairment of assets	4,317	1,705	2,294
Loss (gain) on sale of property	(437)	808	279
Depreciation and amortization	7,173	6,894	6,316
Gain on acquisition of controlling interest in subsidiary	-	(229)	-
Gain on contractual debt reduction	-	-	(5,642)
Adjusted EBITDA	\$ 34,531	\$ 34,125	\$ 31,703
Reconciliation of GAAP net income to non-GAAP net income			
GAAP net income	\$ 11,089	\$ 9,312	\$ 11,240
Amortization of intangibles	752	737	336
Stock-based compensation	360	480	282
Litigation and other one-time settlements	1,881	11,684	3,696
Gain on settlement of patron tax case	-	(8,167)	-
Impairment of assets	4,317	1,705	2,294
Income tax expense	2,657	5,164	5,916
Loss (gain) on sale of property	(437)	808	279
Gain on acquisition of controlling interest in subsidiary	-	(229)	-
Gain on contractual debt reduction	-	-	(5,642)
Non-GAAP provision for income taxes			
Current	(5,053)	(6,095)	(5,273)
Deferred	(2,164)	(1,428)	(1,167)
Non-GAAP net income	\$ 13,402	\$ 13,971	\$ 11,961
Reconciliation of GAAP diluted net income per share to non-GAAP diluted net income per share			
Fully diluted shares	10,229	10,406	10,637
GAAP net income	\$ 1.10	\$ 0.90	\$ 1.13
Amortization of intangibles	0.07	0.07	0.03
Stock-based compensation	0.04	0.05	0.03
Litigation and other one-time settlements	0.18	1.12	0.35
Gain on settlement of patron tax case	-	(0.78)	-
Impairment of assets	0.42	0.16	0.22
Income tax expense	0.26	0.50	0.56
Loss (gain) on sale of property	(0.04)	0.08	0.03

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

Gain on acquisition of controlling interest in subsidiary	-	(0.02)	-
Gain on contractual debt reduction	-	-	(0.53)
Non-GAAP provision for income taxes			
Current	(0.49)	(0.58)	(0.49)
Deferred	(0.21)	(0.14)	(0.11)
Non-GAAP diluted net income per share	\$1.32	\$1.35	\$1.20

Reconciliation of GAAP operating income to non-GAAP operating income

GAAP operating income	\$20,848	\$20,878	\$18,875
Amortization of intangibles	752	737	336
Stock-based compensation	360	480	282
Litigation and other one-time settlements	1,881	11,684	3,696
Gain on settlement of patron tax case	-	(8,167)	-
Impairment of assets	4,317	1,705	2,294
Loss (gain) on sale of property	(437)	808	279
Non-GAAP operating income	\$27,721	\$28,125	\$25,762

Reconciliation of GAAP operating margin to non-GAAP operating margin

GAAP operating income	15.5 %	15.4 %	15.5 %
Amortization of intangibles	0.6 %	0.5 %	0.3 %
Stock-based compensation	0.3 %	0.4 %	0.2 %
Litigation and other one-time settlements	1.4 %	8.6 %	3.0 %
Gain on settlement of patron tax case	0.0 %	-6.0 %	0.0 %
Impairment of assets	3.2 %	1.3 %	1.9 %
Loss (gain) on sale of property	-0.3 %	0.6 %	0.2 %
Non-GAAP operating margin	20.6 %	20.8 %	21.2 %

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

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

During the current year, we have excluded pre-opening and acquisitions costs, which were previously included, and have included gain/loss on sale of controlling interest in subsidiary, which were previously excluded, in our adjustments for non-GAAP financial performance measures since we believe that these are recurring cash operating expenses that are necessary to operate our business. We have appropriately included or excluded the same items from prior year comparable non-GAAP financial performance measure to conform to the current year presentation.

LIQUIDITY AND CAPITAL RESOURCES

We believe our ability to generate cash from operating activities is one of our fundamental financial strengths. Refer to the heading “Cash Flows from Operating Activities” below. The near-term outlook for our business remains strong, and we expect to generate substantial cash flows from operations in fiscal 2017. As a result of our expected cash flows from operations, we have significant flexibility to meet our financial commitments. The Company has not recently raised capital through the issuance of equity securities. Instead, we use debt financing to lower our overall cost of capital and increase our return on stockholders’ equity. Refer to the heading “Cash Flows from Financing Activities” below. We have a history of borrowing funds in private transactions and from sellers in acquisition transactions and continue to have the ability to borrow funds at reasonable interest rates in that manner. We have historically utilized these cash flows to invest in property and equipment, adult nightclubs and restaurants/sports bars. Refer to the heading “Cash Flows from Investing Activities” below.

As of September 30, 2016, we had a working capital deficit of \$2.7 million (excluding the impact of assets held for sale amounting to \$7.7 million) compared to a working capital deficit of \$5.7 million as of September 30, 2015. The decrease in deficit is principally due the following items:

Operating cash flow for the year;

Net increase in liabilities due to the settlement payment of the New York lawsuit and reclassification of its long-term portion to current;

Increase in current portion of long-term debt

Cash Flows from Operating Activities

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

	Year Ended September 30,		
	2016	2015	2014
Net income	\$10,340	\$8,989	\$10,997
Depreciation and amortization	7,173	6,894	6,316
Deferred taxes	1,427	3,935	937
Stock compensation expense	360	480	282
Gain on contractual debt reduction	-	-	(5,642)
Gain on settlement of patron tax	-	(8,167)	-
Impairment of assets	4,317	1,705	2,294
Change in operating assets and liabilities	(503)	1,951	4,900
Other	(83)	577	351
	\$23,031	\$16,364	\$20,435

Cash Flows from Investing Activities

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

	Year Ended September 30,		
	2016	2015	2014
Net activities in marketable securities and other assets	\$4,048	\$-	\$438
Acquisition of development rights in New York Building	-	-	(5,325)
Additions to property and equipment	(28,148)	(19,259)	(16,034)
Additions of businesses, net of cash acquired	-	(2,328)	(500)
	\$(24,100)	\$(21,587)	\$(21,421)

Following is a reconciliation of our additions to property and equipment for the years ended September 30, 2016, 2015 and 2014 (in thousands):

	Year Ended September 30,		
	2016	2015	2014
Acquisition of real estate	\$22,174	\$23,843	\$3,348
Capital expenditures funded by debt	-	(7,978)	(4,879)

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

New capital expenditures in new clubs and purchase of aircraft	3,456	1,919	15,864
Maintenance capital expenditures	2,518	1,475	1,701
Total capital expenditures in consolidated statement of cash flows	\$28,148	\$19,259	\$16,034

Cash Flows from Financing Activities

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

	Year Ended September 30,		
	2016	2015	2014
Proceeds from long-term debt	\$32,049	\$18,283	\$7,025
Payment of dividends	(862)	-	-
Payments on long-term debt	(19,159)	(12,579)	(8,473)
Purchase of treasury stock	(7,311)	(2,296)	(1,150)
Exercise of stock options and warrants	500	87	3,126
Payment of loan origination costs	(624)	-	-
Distribution of noncontrolling interests	(217)	(216)	(216)
	\$4,376	\$3,279	\$312

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

	Year Ended September 30,		
	2016	2015	2014
Operating activities	\$23,031	\$16,364	\$20,435
Investing activities	(24,100)	(21,587)	(21,421)
Financing activities	4,376	3,279	312
Net increase (decrease) in cash	\$3,307	\$(1,944)	\$(674)

We require capital principally for the acquisition of new units, renovation of older units and investments in technology. We may also utilize capital to repurchase our common stock as part of our share repurchase program and to pay our quarterly dividends.

Non-GAAP Cash Flow Measure:

Management also uses certain non-GAAP cash flow measures such as free cash flows. Free cash flows is derived from net cash provided by operating activities less maintenance capital expenditures.

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

	2016	2015	2014
Net cash provided by operating activities	\$23,031	\$16,364	\$20,435
Less: Maintenance capital expenditures	2,518	1,475	1,701
Free cash flows	\$20,513	\$14,889	\$18,734

Debt Financing:

See Note H - Long-term Debt of Notes to Consolidated Financial Statements for detail regarding our long-term debt activity.

Contractual obligations and commitments:

We have long term contractual obligations primarily in the form of debt obligations and operating leases. The following table (in thousands) summarizes our contractual obligations and their aggregate maturities as well as future minimum rent payments. Future interest payments related to variable interest rate debt were estimated using the interest rate in effect at September 30, 2016.

	Payments Due by Period						
	Total	2017	2018	2019	2020	2021	Thereafter
Long-term debt - regular	\$47,088	\$7,793	\$8,102	\$8,130	\$8,514	\$5,324	\$9,225
Long-term debt - balloon	59,490	2,157	12,419	2,344	18,354	5,211	19,005
Interest payments	30,362	7,719	6,666	5,982	4,583	3,317	2,095
Operating leases	25,107	1,863	1,800	1,674	1,727	1,718	16,325

In October 2016, the Company refinanced \$8.0 million of long-term debt by borrowing \$9.9 million. The new unsecured debt is payable \$118,817 per month, including interest at 12%, and matures in five years with a balloon payment for the remaining balance at maturity. The refinanced debt was comprised of interest-only notes that were scheduled to mature with full principal payments in fiscal 2018.

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

The following table presents a summary of such indicators (dollars in thousands):

	2016	Increase (Decrease)	2015	Increase (Decrease)	2014
Sales of alcoholic beverages	\$57,216	2.5	% \$55,829	16.6	% \$47,893
Sales of food and merchandise	17,900	-4.3	% 18,713	27.6	% 14,669
Service Revenues	51,276	-3.3	% 53,014	2.0	% 51,972

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

Other	8,468	7.3	% 7,893	14.4	% 6,898
Total Revenues	\$134,860	-0.4	% \$135,449	11.5	% \$121,432
Net cash provided by operating activities	\$23,031	40.7	% \$16,364	-19.9	% \$20,435
Adjusted EBITDA	\$34,531	1.2	% \$34,125	7.6	% \$31,703
Long-term debt	\$105,886	12.2	% \$94,349	34.6	% \$70,092

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

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

Share repurchase

As part of our capital allocation strategy, we buy back shares in the open market or through negotiated purchases, as authorized by our Board of Directors. During fiscal years 2016, 2015 and 2014, we paid for treasury stock amounting to \$7.3 million, \$2.3 million and \$1.2 million representing 747,081 shares, 225,280 shares and 101,330 shares, respectively. We have \$4.2 million remaining to purchase additional shares as of September 30, 2016.

For additional details regarding our Board approved share repurchase plans, please refer to Item 5 – Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

IMPACT OF INFLATION

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

SEASONALITY

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

GROWTH STRATEGY

We believe that our nightclub operations can continue to grow organically and through careful entry into markets and demographic segments with high growth potential. Our growth strategy is: (i) to open new units after market analysis, (ii) to acquire existing units in locations that are consistent with our growth and income targets and which appear

receptive to our capital allocation strategy (see discussion in Item 1 – Business), (iii) to form joint ventures or partnerships to reduce start-up and operating costs, with us contributing equity in the form of our brand name and management expertise, (iv) to develop new club concepts that are consistent with our management and marketing skills, and/or (v) to acquire real estate in connection with club operations, although some units may be in leased premises.

Additionally, we believe that our restaurants/sports bars can also grow organically and through careful entry into markets and demographic segments with high growth potential. Our growth strategy is to diversify our operations with these units which do not require SOB licenses, which are sometimes difficult to obtain. While we are searching for adult nightclubs to acquire, we are able to also search for restaurant/sports bar locations that are consistent with our income targets.

We also expect to develop our franchising business through Bombshells. In November 2016, we started to formally organize our franchising department through the hiring of a new Vice President of Franchise and Development, who has vast experience in all aspects of retail franchising. We target franchise Bombshell units to have average unit volumes of approximately \$4.0 million.

During fiscal 2016, we did not acquire any new club, restaurant or investment, in adherence to our capital allocation strategy. We acquired land for \$5.9 million for future Bombshells sites. In September 2016, we opened Hoops Cabaret and Sports Bar in New York City.

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The items in our financial statements subject to market risk are debt instruments with variable interest rates, aggregating \$4.4 million at September 30, 2016. The note bears interest at 2% above prime with a floor of 5%. If the prime rate were to rise, the effect on our annual statement of income would be \$44,000, before taxes, for each 1% rise above a prime rate of 3.5%.

Item 8. Financial Statements and Supplementary Data.

The information required by this Item begins on page 35.

RCI HOSPITALITY HOLDINGS, INC.

CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

<u>Reports of Independent Registered Public Accounting Firm</u>	36
Consolidated Financial Statements:	
<u>Consolidated Balance Sheets at September 30, 2016 and 2015</u>	38
<u>Consolidated Statements of Income for the years ended September 30, 2016, 2015 and 2014</u>	39
<u>Consolidated Statements of Comprehensive Income for the years ended September 30, 2016, 2015 and 2014</u>	40
<u>Consolidated Statements of Changes in Stockholders' Equity for the years ended September 30, 2016, 2015 and 2014</u>	41
<u>Consolidated Statements of Cash Flows for the years ended September 30, 2016, 2015 and 2014</u>	42
<u>Notes to Consolidated Financial Statements</u>	44

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
RCI Hospitality Holdings, Inc.

We have audited the accompanying consolidated balance sheets of RCI Hospitality Holdings, Inc. and subsidiaries (the “Company”), as of September 30, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in stockholders’ equity, and cash flows for each of the years in the three-year period ended September 30, 2016. The Company’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RCI Hospitality Holdings, Inc. and subsidiaries, as of September 30, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2016, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of September 30, 2016, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated December 13, 2016, expressed an unqualified opinion.

/s/ Whitley Penn LLP
Dallas, Texas
December 13, 2016

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

RCI Hospitality Holdings, Inc.

We have audited RCI Hospitality Holdings, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of September 30, 2016, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2016, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows of the Company, and our report dated December 13, 2016, expressed an unqualified opinion on those consolidated financial statements.

/s/ Whitley Penn LLP
Dallas, Texas
December 13, 2016