Robert Dunn **Michael Wolleben**

- ✓ RCI Hospitality (NASDAQ: RICK) operates two primary business segments: (1) Nightclubs (~70% of consolidated sales and 80% of adj. EBITDA in F2021), which owns and operates 50 gentlemen's clubs in 13 U.S. states; and (2) Bombshells (~29% of total revenue and ~20% of adj. EBITDA), which operates 12 military-themed, casual dining restaurants & bars. The "Other" segment (~1% of sales in F2021), is primarily comprised of RICK's media division along with sales of the energy drink, Robust.

- ✓ In our view, RICK, which, on a consolidated basis, targets compound annual free cash flow per share (FCF) growth of 10%-15% (at minimum), is, at ~6.5x F2024E EBITDA and a FCF yield of ~12.5%, undervalued relative to the sum value of its parts. On the fundamental front, in pursuit of its FCF goals, RICK intends to further consolidate the Nightclubs business, which enjoys structural barriers to entry and generates high margins with durable cash flow, at 3x-5x EBITDA (and cash-on-cash returns of 25%-33%), as well as organically expand its Bombshells sports bar concept, via both company-owned and franchised locations (again, targeting cash-on-cash returns of 25%-33%). RICK will also repurchase shares when its FCF yield exceeds 10%. On the transactional front, we think RICK's Bombshells concept presents optionality for a spin-off or sale as it gains incremental scale toward ~$50 million of annual EBITDA. (In fact, management has anecdotally indicated that a financial sponsor offered ~14x, or ~$280 million, for Bombshells in mid-2021, but the company concluded the transaction was premature and offered inadequate value.)

- ✓ Based on management commentary as well as peer and M&A valuations, value of $81 per share and $30 per share can be assigned to RICK's Nightclubs and Bombshells businesses, respectively. Accounting for projected net debt and corporate costs of ~$37 per share yields a base case sum-of-the-parts fair value of ~$74 per share (with bull and bear cases of $52.50 and $95.50, respectively).

- ✓ Potential catalysts include a spin-off or sale, better than expected growth/margins/FCF, stock buybacks, and/or acquisitions. Potential risks include execution, regulatory changes, including on employment classifications, zoning and liquor licenses, cost inflation, changes in behavior, insurance liability, a pandemic, and/or a recession.

RCI Hospitality Holdings, Inc.

(NASDAQ: RICK)

Date (6/30/22)

Price $48.46/share

Market capitalization ~$465M

Nightclubs: $81 per share

Bombshell: $30 per share

Corporate, Other & Net Debt: ($37 per share)

SOTP: $74 per share*

*SOTP may not add due to rounding

NOTE: This publication could be considered as advocating for corporate restructurings. Authors select companies for this report based on the potential for a future value-unlocking transaction. In many cases, these companies have or could come under activist investor pressure, media scrutiny, or general market speculation that a spin-off or asset sale is possible.

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The Background

RCI Hospitality (NASDAQ: RICK), headquartered in Houston, TX, was founded in 1983 by Robert Watters, who established the Rick's Cabaret brand of "gentlemen's clubs". The company went public in 1995 and in 1998 merged with Taurus, Inc., the owner of XTC Cabaret, which was controlled by current chairman and chief executive, Eric Langan (who currently owns ~7.5% of RICK's outstanding shares). In 2005, RICK entered the Manhattan market, and subsequently, in 2008, entered the South Florida market via the purchase of Tootsie's Cabaret in Miami Gardens. In succeeding years, largely via the consolidation of existing clubs (given the nearly impassable regulatory hurdles associated with organic growth in the industry), RICK expanded its presence in Texas as well moving into other states, including Arizona, Louisiana, Minnesota, Missouri, Illinois, Pennsylvania, Kentucky, North Carolina, Maine, and Colorado. In 2013, the company opened its first Bombshells Restaurant & Bar location, in Dallas, TX. Today, RICK's reports two primary segments: (1) Nightclubs (70% of consolidated sales and 80% of adjusted EBITDA in September-ending F2021), which owns and operates 50 gentlemen's clubs in 13 states; and (2) Bombshells (29% of sales and ~20% of adjusted EBITDA in F2021), which operates 11 company-owned military-themed sports bars & restaurants and one franchised location. (The "Other" segment, which contributed ~1% of sales in F2021, is primarily comprised of its media division, which owns industry trade magazines and trade shows, along with several social media websites, including AdmireMe.com, as well sales of the energy drink, Robust.) (See Background #1.)

Background #1 RCI Hospitality: Consolidated Selected Financial Items, F2018–F2024E
($ in millions)

	F2018	F2019	F2020	F2021	F2022E	F2023E	F2024E
Sales:							
Nightclubs	$140.1	$148.6	$88.4	$137.3	$214.3	$210.3	$227.5
Bombshells	$24.1	$30.8	$43.2	$56.6	$63.8	$74.1	$88.0
Other	$1.6	$1.6	$0.7	$1.3	$1.4	$1.4	$1.5
Total	**$165.7**	**$181.1**	**$132.3**	**$195.3**	**$279.4**	**$285.8**	**$317.0**
Ad. income from operations:							
Nightclubs	$43.6	$53.5	$23.6	$56.1	$77.8	$72.9	$82.7
Bombshells	$2.0	$2.3	$9.5	$13.4	$13.9	$16.3	$20.0
Other	($0.3)	$0.1	($0.2)	$0.1	($0.2)	($0.2)	($0.2)
Corporate	($17.9)	($18.0)	($19.0)	($17.6)	($24.0)	($24.3)	($24.8)
Total	**$27.6**	**$37.9**	**$13.9**	**$52.0**	**$67.6**	**$64.8**	**$77.7**
Adjusted EBITDA:							
Nightclubs	$49.0	$59.9	$29.4	$61.6	$85.6	$80.9	$91.0
Bombshells	$3.3	$3.7	$11.3	$15.2	$15.8	$18.6	$22.5
Other	($0.1)	$0.5	$0.2	$0.2	($0.2)	($0.2)	($0.2)
Corporate	($17.0)	($17.1)	($18.1)	($16.7)	($23.1)	($23.4)	($23.9)
Total	**$35.3**	**$47.0**	**$22.7**	**$60.3**	**$78.2**	**$75.9**	**$89.5**
Adjusted EBITDA (as reported)	$44.4	$46.2	$22.4	$60.2	$78.2	$75.9	$89.5
Capital expenditures:							
Nightclubs	$2.1	$6.6	$3.5	$6.9	$21.4	$21.0	$22.7
Bombshells	$22.5	$10.5	$2.1	$5.9	$4.8	$7.5	$8.8
Other	$0.0	$0.0	$0.0	$0.2	$1.0	$1.0	$1.0
Corporate	$0.7	$3.6	$0.1	$0.6	$0.8	$0.9	$1.0
Total	**$25.3**	**$20.7**	**$5.7**	**$13.5**	**$28.1**	**$30.4**	**$33.5**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

For some financial context on the following discussion, while RICK does not provide any explicit financial guidance, recent management commentary anecdotally suggests F2022 sales and free cash flow could be ~$260-$280 million and $50-$60 million, respectively. More broadly, management's operating philosophy since F2016 has been heavily influenced by lessons garnered from the book *The Outsiders* by William Thorndike, which chronicles the careers of eight chief executives who excelled at capital allocation and shareholder value creation (by specifically focusing on growth in per share cash flow as opposed to sales or reported earnings). In that respect, RICK's broad financial target is to "drive shareholder value by increasing free cash flow per share 10%-15% on a compound annual basis." Anecdotally, the personal target of RICK's chief executive, Eric Langan, is to generate 20%-plus compound annual free cash flow growth, but his preference is to "under promise and over deliver." For additional near-term context, in a recent interview with Benzinga, Mr. Langan commented that RICK should grow free cash flow at a ~30% clip in F2022E (and said he thought, given the acquisition pipeline, that figure could be repeatable in F2023E). (Note: RICK defines free cash flow internally as operating cash flow less maintenance capex.)

In the pursuit of its free cash flow goals, the company's capital allocation strategy focuses on three core avenues: acquisitions, organic growth, and share repurchases. (1) Acquisitions: With regard to acquisitions, RICK is primarily focused on the Nightclubs sector, where the barriers to entry are significant and the company looks to purchase cash-generative gentlemen's clubs in attractive/growing markets at ~3x-5x adjusted EBITDA (while using a combination of cash and seller financing to buy the underlying real estate at or below market value) with the goal of generating annual cash-on-cash returns of at least 25%-33%. For context, despite being among the largest operators in the industry, RICK's market share (of the roughly 2,200 clubs in the U.S.) is only around 2%, but management sees a universe of roughly 500 potential club acquisitions that fit into its so-called "wheelhouse." In that context, given the current pipeline of potential transactions, which include both multi-site and single-site operators, the company is targeting near-term delas that add ~$20 million of incremental adjusted EBITDA in F2023. (2) Organic growth: In pursuing organic growth, RICK is focusing primarily on its Bombshells sports-bar concept, again with the goal of generating annual cash-on-cash returns of at least 25%-33% on its investments. The company targets opening ~14 additional locations, including 9 company-owned locations and 5 franchises, through F2025. (3) Share repurchases: This approach will be employed only when RICK's free cash flow yield exceeds 10%. In 1H 2022, the company repurchased ~45,643 shares for ~$2.85 million, or ~$62.33 per share, and indicated that as of early May 2022 it had repurchased an additional 37,700 shares, for $2.4 million or ~$63.65 per share, at which time we calculated the company's existing authorization was ~$3.7 million. Later in May, the company increased its repurchase authorization by $25 million, and management has indicated that it expects to remain active in the market with the stock below $65 per share and incrementally more aggressive under $60 per share. That said, the company also indicates that it is currently seeking opportunities to make growth investments that earn cash-on-cash returns of 25%-50%, so we expect the company to remain disciplined/balanced on the near-term repurchase front.

Nightclubs

The Nightclubs segment (70% of consolidated sales and ~80% of adjusted EBITDA in F2021) owns and operates 50 gentlemen's clubs in 13 states, with a concentration in Texas (25 clubs) as well as Denver (5), New York (4), and Florida (2), along with Arizona (AZ), Pennsylvania (PA), Illinois (IL), Indiana (IN), Kentucky (KY), Louisiana (LA), Maine (ME), Minnesota (MN), and North Carolina (NC), primarily under the Rick's Cabaret (elegant clubs with restaurants), Scarlett's (high-end, high-energy party clubs), Vivid Cabaret (also high-end, high-energy party clubs), Tootsie's Cabaret (the nation's largest club with ~78,000 sq. ft. in Miami), Club Onyx (high-end clubs for African-American professionals), XTC Cabaret ("bring your own" alcohol clubs with a blue-collar and college-aged clientele), and Jaguars Club (also "bring your own" alcohol clubs with a blue-collar and college-aged clientele) brands. (See Background #2.) The company also operates a stable of ancillary brands, including Temptations, Foxy Cabaret, Country Rock Cabaret, La Boheme, Hoops Cabaret, Kappa Men's Club, The Mansion, The Seville Club, and Silver City Cabaret, as well as Studio 80, an eighties-themed dance club in Fort Worth, TX. While Texas is the company's biggest market in terms of the number of locations, we estimate that RICK generates ~40% of its profits in Florida, primarily from Tootsie's and Scarlett's, which we estimate generate ~$25 million and $8-$10 million of annual EBITDA, respectively, followed by Texas, which in aggregate likely generates ~$25-$30 million, and New York, where the Rick's Cabaret location in midtown Manhattan, with close proximity to Madison Square Garden, by itself likely generates ~$10 million of annual EBITDA.

Background #2 RCI Hospitality: Nightclubs Segment – Brand Portfolio, Selected Items

Elegant clubs with restaurants	High-end, high-energy party clubs	High-end, high-energy party clubs	Largest club in U.S. with 78,000 sq. ft.	High-end clubs for African American professionals	Lively BYOB clubs for blue collar patrons and the college crowd	Lively BYOB clubs for blue collar patrons and the college crowd

Source: Company reports.

RICK's Nightclubs business primarily generates revenue from the sale of: (1) alcoholic beverages (39.5% of segment sales in F2021); (2) food and merchandise (12.5% of segment sales); and (3) services (~40% of segment sales), which includes cover charges, automatic teller (ATM) fees/so-called "dance dollars" as well as VIP room rentals. (The remaining ~8%, categorized as "other," is generated primarily by real estate rental revenue.) The Nightclubs business consistently generates gross margins in the high-80%s (i.e., 88%-89%) and has relatively low maintenance capital requirements. For its part, given recent upgrades to its systems and its streamlining/cost-cutting efforts during the pandemic, management estimates its future operating margin profile could fluctuate in the 40%-55% range, depending on VIP spend (and the impact of sporting event, such as the Super Bowl, that periodically occur in close proximity to one of the company's locations).

Per estimates, there are roughly 2,200 gentlemen's clubs in the U.S., generating annual sales of ~$7-$8 billion, implying that, although RICK is among the largest players (and the only public one), its market share is still just ~2%. While other multi-site chains, such as Deja Vu (~200 locations globally) and Spearmint Rhino (~23 locations in the U.S., U.K., and Australia), exist the industry remains highly fragmented. Notably, the industry, at least from the perspective of aggregate locations, is largely expected to remain stagnant, at best, primarily due to local regulations, which essentially preclude the future establishment of new clubs (as municipal licenses are almost uniformly tied to a physical location, and municipalities rarely issue new licenses). In that context, management has articulated the salient point that it is "the moat that's most exciting about our industry is that we buy these cash flow machines and they just sit there and operate and operate and operate. There's not a lot of competition that's going to come into the market and make any major changes to the cash flow." Notably, within the aforementioned population of gentlemen's clubs, RICK has identified roughly 500 locations as being in its "wheelhouse" (which is to say the locations are in areas that are geographically and demographically attractive).

In terms of future acquisitions, the company will look to further penetrate existing markets, specifically AZ, CO, TX and FL, where there is potentially a "competitor that we can buy" and "control more market share" in the area as well as enter new markets (e.g., the recent addition of cities such as Denver, St. Louis, Raleigh, Louisville and Portland) or adjacent ones (e.g., Wisconsin and Michigan). Internationally, management indicates that it is "definitely not adverse" to potentially entering the Canadian market at some point and that it has, in fact, looked at targets in Vancouver and Toronto (but ultimately never pulled the trigger for a variety of transaction-specific reasons). As mentioned earlier, the company intends to pay 3x-5x EBITDA, skewed to the lower end for single-club type transactions and toward the higher end for multi-club transactions, with the goal of generating cash-on-cash returns of 25%-33%. The company will also seek to acquire the underlying real estate associated with its targets at or below market value, using a combination of cash and seller financing. In terms of the pipeline, RICK remains interested in acquiring multi-unit chains and indicates that its pipeline contains several potential deals in the 3-6-club range, including one that could add ~$8 million of incremental EBITDA, along with other smaller or single-site targets that are under "active" discussion. All told, the company is targeting near-term acquisitions that could add ~$20 million of incremental EBITDA in F2023, which is a goal that management expects to achieve "without too much problem at all." (In our view, RICK has emerged as the most logical buyer of nightclub assets given its industry expertise, reputation, and access to capital, as well as the relative dearth of private equity involvement in the space. In that regard, management notes a recent uptick in incoming calls from both brokers and club owners.)

In terms of recent acquisitions, in October 2021 the company acquired 11 sites (previously owned by the Lowrie family), including five locations in Denver, CO, two clubs in St. Louis, MO, and one each in Indianapolis, IN, Louisville, KY, Raleigh, NC, and Portland, ME, for ~$88 million, including $18 million for the underlying real estate at six locations. The purchase price was structured as $26 million in cash, $30 million in stock at $60 per share, $21.2 million in seller financing at 6%, and $10.8 million of bank financing at 5.25%. (As a result, Troy Lowrie is now RICK's fourth largest shareholder, at ~5.3%.) Relative to pre-pandemic results in 2019, when the Lowrie-owned group generated ~$40 million of revenue and ~$14 million of adjusted EBITDA, the purchase price implied a multiple of 5x, excluding real estate. In November 2021, the company purchased The Mansion Gentlemen's Club in Newburgh, NY — the only gentlemen's club with a liquor license in Orange County, NY, a fast-growing suburb of Manhattan — for $3.5 million, including $2 million for the underlying real estate. In May 2022, the company completed the acquisition of the Playmates Club in Miami, FL for $16 million, including $3 million for the underlying real estate. The purchase price of ~$13 million, ex-real estate, was ~4x estimated incremental EBITDA of ~$3 million and was structured as $2 million in cash, $6 million in a 10% three-year promissory note, and $5 million under a 10% ten-year interest-only promissory note (which may be cancelled if any regulatory changes prevent operations over the next ten years). As well, the company opened a new Rick's Steakhouse & Lounge in Miami adjacent to its Scarlett's location. Additionally, the company indicates that it is "under contract" to purchase the property and operating license for an additional nightclub in Fort Worth, TX (but that it will have to do a full remodel, as the location has been closed following the death of its previous owner) and that the company expects to reopen a reformatted club in San Antonio, TX during 3Q 2022. Historically, RICK has typically seen a 15%-20% lift in adjusted EBITDA at its new clubs post-acquisition as its proprietary systems & best practices are instituted and as increased purchasing power is leveraged.

Over the last five years, the Nightclubs business has posted compound annual top-line growth of ~5%, with operating income and EBITDA CAGRs of ~7% and ~13%, respectively. Included in this period was the pandemic-impacted F2020, during which time all of its clubs were closed between March-May and operating restrictions persisted throughout the year, when the Nightclubs segment posted a 40.5% decline in sales to $88.4 million, while adjusted operating income and EBITDA declined 56% and 51% to $23.6 million and $29.4 million, respectively. (In that context, we would note that the Nightclubs segment was unprofitable, to the tune of ~$3 million from an EBIT perspective, only in the June quarter of F2020, with the September quarter generating operating income of more than $100K.) In F2021, Nightclubs segment sales rebounded 55.5% (despite one less unit open) to $137.3 million, while adjusted operating income and EBITDA jumped 138% and 109.5%, respectively, to $56.1 million and $61.6 million. In 1H 2022 (October 2021-March 2022), Nightclubs segment sales, including the closing of the Lowrie acquisition in late October 2021, advanced ~70% to $95 million, while adjusted segment operating income and EBITDA increased 86% and 80.5% to $38 million and $41.8 million, respectively.

While the company is not seeing any signs of an imminent recession, at least at the moment, with the Nightclubs business continuing to experience increases in traffic/revenue on both a month-over-month and week-over-week basis in May and June 2022, it is likely relevant, given current stock market volatility, to discuss the potential impact of an economic recession. On the topic, management has commented that "what we have seen in our industry is not recession proof, but definitely recession-resistant." In that regard, if one looks back to the Great Recession, "you'll see that we have like two quarters where revenue — when earnings decline, revenue stayed pretty strong, earnings declined for two quarters and then boom bounced back up." Specifically, in F2010, RICK's sales declined 2.3% to $74.1 million (from $75.8 million in F2009), while adjusted EBITDA actually increased 15% to $18 million, and EPS remained relatively flat at $0.63 (versus $0.62 in F2009). Free cash flow increased ~67.5% to $11.4 million (versus $6.8 million in F2009), despite an increase in the capital spending budget to $5.9 million (from $2.1 million in F2009). (Note: On an even more granular level, if one looks at the company's four most affected quarters [2H F2010 through 1H F2011], sales fell 11.85% to $72.9 million, versus $82.7 million in the prior-year period, with adjusted EBITDA declining 5.5% to $17.2 million from $18.2 million and EPS falling 5% to $0.76 from $0.80. In F2011, sales rebounded ~13% to $83.5 million, with adjusted EBITDA increasing ~23.5% to $22.7 million and EPS jumping ~51% to $0.95. Free cash flow was $7.3 million, based on a capex budget of $11.5 million.)

For additional context, we would also note that the company's vastly improved geographical diversity and technological sophistication (compared with F2010-F2011, when the company garnered the majority of its earnings in NYC and Las Vegas and lacked the ability to analyze real-time trends at the individual club level and thus was less able to quickly make market-specific adjustments) are important factors that would likely further mitigate any potential deterioration, relative to what was experienced in F2010-F2011. While the company is currently contemplating providing its detailed economic sensitivity analysis to investors, Mr. Langan has recently stated that even in the event of a "big downturn" he believes that RICK's top-line sales would fall by no more than 8%-10% (with the brunt of the decline, perhaps somewhat counterintuitively, likely stemming from its lower-end, so-called "blue collar" clubs). As well, we would note that during/in the wake of the most recent recessionary period, RICK was able to buy Tootsie's in Miami Gardens for $25 million (which generated $18 million of sales and $8.8 million of EBITDA at the time, subsequently growing to ~$25 million in EBITDA) as well as 10 other clubs.

In any event, as mentioned previously, the company is not currently seeing signs of an imminent recession, with month-over-month and week-over-week increases in May and June 2022. Thus, we expect F2022 will finish strongly with ~56% top-line growth to ~$214 million, along with 38% and 39% increases in adjusted operating income and EBITDA to $77.8 million and $85.6 million, respectively. Looking into F2023-F2024, we think it reasonable, in the spirit of conservatism, to project a modest step back for the Nightclubs segment in F2023, albeit with a rebound in F2024, resulting in compound annual top-line and adjusted EBITDA growth of ~6.5% and 7%, respectively, to ~$227.5 million and $91 million (see Background #3).

Background #3 RCI Hospitality: Nightclubs Segment, Selected Items (F2018-F2024E)
($ in millions, except as noted)

	F2018	F2019	F2020	F2021	6 mos. F2021	6 mos. F2022	F2022E	F2023E	F2024E
Sales	**$140.1**	**$148.6**	**$88.4**	**$137.3**	**$56.0**	**$95.0**	**$214.3**	**$210.3**	**$227.5**
Alcoholic beverages	$54.8	$57.3	$32.0	$54.3	$22.3	$36.8	$88.1	$89.3	$96.8
Food & merchandise	$12.7	$13.1	$8.6	$17.2	$7.5	$9.1	$21.6	$21.9	$23.8
Service	$64.1	$67.9	$41.0	$55.1	$21.4	$42.2	$89.4	$83.7	$90.3
Other	$8.5	$10.4	$6.9	$10.7	$4.8	$6.8	$15.1	$15.4	$16.6
Income from operations	**$43.6**	**$50.7**	**$13.1**	**$43.8**	**$19.0**	**$37.9**	**$77.5**	**$72.8**	**$82.6**
Amortization of intangibles		$0.2	$0.2	$0.2	$0.1	$0.1	$0.2	$0.2	$0.2
Legal settlements		$0.2	$0.2	$0.3	$0.1	$0.5	$0.9	-	-
Asset impairments		$5.9	$10.4	$13.6	$1.4	-	-	-	-
Debt financing costs	-	-	-	$0.0	-	-	-	-	-
Loss (gain) on asset sales		($2.9)	($0.6)	($0.6)	$0.0	($0.1)	($0.2)	-	-
Gains on insurance		($0.7)	$0.4	($1.2)	($0.2)	($0.3)	($0.6)	-	-
Adj. income from operations	**$43.6**	**$53.5**	**$23.6**	**$56.1**	**$20.4**	**$38.0**	**$77.8**	**$72.9**	**$82.7**
Depreciation & amortization	$5.4	$6.4	$5.8	$5.5	$2.7	$3.8	$7.8	$8.0	$8.3
Adjusted EBITDA	**$49.0**	**$59.9**	**$29.4**	**$61.6**	**$23.2**	**$41.8**	**$85.6**	**$80.9**	**$91.0**
Operating margin	31.1%	34.1%	14.8%	31.9%	33.9%	39.9%	36.2%	34.6%	36.3%
Adj. operating margin	31.1%	36.0%	26.7%	40.9%	36.5%	40.0%	36.3%	34.7%	36.4%
Adj. EBITDA margin	35.0%	40.3%	33.3%	44.9%	41.4%	44.0%	40.0%	38.5%	40.0%
Capital expenditures	**$2.1**	**$6.6**	**$3.5**	**$6.9**	**$3.3**	**$10.9**	**$21.4**	**$21.0**	**$22.7**
Units	**37.0**	**38.0**	**38.0**	**37.0**	**37.0**	**48.0**	**50.0**	**52.0**	**55.0**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Bombshells

The Bombshells segment (29% of consolidated sales and ~20% of adjusted EBITDA in F2021) operates 11 company-owned locations throughout Texas and one franchised location in San Antonio. Bombshells is a military-themed sports bar & restaurant, which features décor that pays homage to all branches of the U.S. military while fostering a fun and energetic atmosphere with locations featuring local entertainment, large outdoor patios, plentiful parking, and state-of-the-art flat-screen TVs (primarily tuned to various sporting events; see Background #4). The waitstaff don military-style uniforms, and the food and drink, which are prepared in a so-called "scratch kitchen," have military-inspired monikers (e.g., Sherman's cheesesteak, the Airborne Ranger burger, the Officer's club sandwich, Paratrooper pasta, and the B-17 wings, which are served with sauces varying from "thunderbolt" to "nuclear"). The average check, per person, is around $35.

Background #4 RCI Hospitality: Bombshells Segment – Concept Illustration, Selected Items

Source: Company reports.

Similar to the Nightclubs business (albeit with a markedly different mix), Bombshells primarily generates revenue from the sale of: (1) alcoholic beverages (57% of segment sales in F2021); (2) food and merchandise (42% of segment sales); and (3) services/other (~1% of segment sales in F2021). Management targets operating margins of 18%-22%, which we note is based on the underlying assumption that each unit (or box) generates ~$5 million of annual sales. That said, the company indicates that its newer locations are generating ~$6-$7 million in annual sales, with operating margins exceeding 30%. This offsets weaker performance at several of the older locations that were opened before management, by its own admission, had refined its market analysis processes and that generate annual sales of ~$3-$4 million per location. In that regard, management concedes that as new locations open in prime areas, margins could normalize in the 22%-27% range (with the more specific commentary that margins in the 24%-25% range ultimately could be sustainable).

RICK opened its first company-owned Bombshells Restaurant & Bar in Dallas, TX in March 2013. In subsequent years the company has expanded its company-owned footprint within Texas by adding a location in Austin, eight in the greater Houston area, and, most recently, in December 2021, one in Arlington, TX (in the Dallas/Fort Worth market). In March 2022, the company closed on the purchase of a property for its 12th company-owned location in Stafford, TX (outside Houston), and it is currently in contract to purchase the property for its 13th and 14th locations in

Sapphire Bay Marina (outside of Dallas, TX) and Lubbock (in northwest Texas), respectively. All told, RICK is targeting the expansion of its company-owned footprint to 20 sites over the next 2-3 years and notes that it is actively looking at six new sites in Austin, TX, Dallas, TX, Phoenix, AZ, and all the major markets in Florida. As alluded to in the previous paragraph, it admittedly took RICK some time to "figure out" the restaurant business and refine its go-to market strategy, most importantly site selection; to that end, the company indicates that while several (i.e., 2-3) of its earlier Bombshells restaurants are "underperforming" (with annual sales of $3-$4 million per unit), its newest 4-5 locations (opened in 2019-2021) are generating annual sales per unit of $6-$7 million (and operating margins of 30%-plus).

In mid-2017, the company launched a franchise initiative at Bombshells, and in December 2020 it formally announced its first franchise development agreement. The agreement calls for the opening of three locations over five years in San Antonio, TX, of which the first opened on June 27, 2022, along with the right of first refusal for three more locations in Corpus Christi, TX, New Braunfels, TX, and San Marcos, TX. The franchisee is a group of Houston-based investors with previous franchise management and restaurant ownership experience (albeit in the pizza space). More recently, in May 2022, the company signed its second franchise agreement with hospitality entrepreneur Jerry Westlund to open three locations over five years in Alabama, with the first locations being planned in Huntsville, AL. (The Nashville-based Mr. Westlund owns ~30 bars/restaurants across 12, primarily Southern, U.S. states.) Management also indicates that they are currently engaged in "serious talks" with three other potential franchise groups (two of which we gather are already approved but are still in the process of, among other things, identifying specific locations that meet zoning and licensing requirements). While the company's public target is to open five additional franchised units over the next 2-3 years, it seems evident, per management commentary, that RICK is keen to accelerate growth in the coming years. To that end, management indicates that they would "love" to begin opening six franchised locations every year and subsequently accelerate that pace to 12-16 locations annually, commenting that, "Well, the idea is for 2023 to open a store every two months. And by the end of 2023, be to the point where we're actually opening a store every eight weeks, and possibly every six weeks. I would like to see in 2025 us being able to open 12 or 16 locations a year by 2025, with two separate opening teams." In terms of the economics, RICK receives an upfront fee of ~$50,000 and "a 5.5% gross royalty"; so assuming "the average franchisee will do about $5 million in sales, which will create basically after cost for us I think about $250,000 in revenue. And basically there's no cost against that so other than taxes. So basically it's going to be – go right to the bottom line."

Longer term (i.e., 5-plus years), RICK's aspiration for the Bombshells concept is to establish a footprint of 80-100 locations (with the commentary that achieving the high end of that range should not be "difficult at all"). For some broader context on the long-term potential, in response to an investor's assertion on the 1Q 2022 conference call that at 100 locations Bombshells would be a "$200 million EBITDA business," Mr. Langan responded with a definitive "Yes."

Over the last five years, the Bombshells business has posted compound annual top-line growth of ~32%, with adjusted operating income and EBITDA CAGRs of ~85% and ~62%, respectively. In F2020, including the addition of two new locations, the Bombshells segment posted sales growth of ~40% to $43.2 million, while adjusted operating income more than tripled to $9.5 million, and adjusted EBITDA advanced ~203.5% to $11.3 million. In F2021, Bombshells segment sales increased 31% to $56.6 million (although the unit count remained flat), with a 41% increase in adjusted operating income to $13.4 million and a ~35% rise in adjusted EBITDA to $15.2 million. In 1H 2022 (October 2021-March 2022), Bombshells segment sales, including the opening of one new location, advanced ~15% to $30.1 million, while adjusted segment operating income and EBITDA increased 6% and ~5% to $6.3 million and $7.2 million, respectively. The company has thus far been successful in passing through food and labor inflation, a feat that management attributes, in part, to its increased use of QR codes, which allow the frequent update of its listed prices (compared with paper menus that need to be reprinted).

For our part, we project that Bombshells' unit count could grow to 20 (with 15 company-owned and 5 franchise locations) in F2024, which we estimate will drive compound annual top-line growth of ~17.5%, with adjusted operating income and EBITDA advancing 20% and 19%, respectively, resulting in F2024E sales, adjusted operating income, and adjusted EBITDA of $88.0 million, $20.0 million, and $22.5 million, respectively (see Background #5).

Background #5 RCI Hospitality: Bombshells Segment, Selected Items (F2018-F2024E)
($ in millions, except as noted)

	F2018	F2019	F2020	F2021	6 mos. F2021	6 mos. F2022	F2022E	F2023E	F2024E
Sales	**$24.1**	**$30.8**	**$43.2**	**$56.6**	**$26.1**	**$30.1**	**$63.8**	**$74.1**	**$88.0**
Alcoholic beverages	$14.3	$17.9	$27.1	$32.4	$15.4	$16.9	$35.7	$41.4	$49.2
Food & merchandise	$9.7	$12.8	$15.9	$23.9	$10.6	$13.0	$27.6	$32.1	$38.1
Service	$0.1	$0.2	$0.2	$0.3	$0.1	$0.2	$0.5	$0.6	$0.7
Other	$0.02	$0.02	$0.03	$0.04	$0.02	$0.02	$0.0	$0.0	$0.1
Income from operations	**$2.0**	**$2.3**	**$9.2**	**$13.3**	**$5.9**	**$6.3**	**$13.9**	**$16.3**	**$20.0**
Amortization of intangibles		$0.0	$0.0	$0.0	$0.0	$0.0	$0.00	-	-
Legal settlements		$0.0	-	$0.1	$0.0	$0.0	$0.02	-	-
Asset impairments	-	-	$0.2	-	-	-	-	-	-
Debt financing costs	-	-	-	-	-	-	-	-	-
Loss (gain) on asset sales		$0.0	$0.0	$0.1	$0.0	$0.0	$0.0	-	-
Gains on insurance	-	-	-	-	-	-	-	-	-
Adj. income from operations	**$2.0**	**$2.3**	**$9.5**	**$13.4**	**$5.9**	**$6.3**	**$13.9**	**$16.3**	**$20.0**
Depreciation & amortization	$1.3	$1.4	$1.8	$1.8	$0.9	$0.9	$1.9	$2.2	$2.5
Adjusted EBITDA	**$3.3**	**$3.7**	**$11.3**	**$15.2**	**$6.9**	**$7.2**	**$15.8**	**$18.6**	**$22.5**
Operating margin	8.5%	7.5%	21.4%	23.4%	22.4%	20.8%	21.8%	22.1%	22.7%
Adj. operating margin	8.5%	7.6%	22.0%	23.7%	22.7%	20.9%	21.8%	22.1%	22.7%
Adj. EBITDA margin	13.7%	12.1%	26.1%	26.9%	26.3%	23.9%	24.8%	25.0%	25.5%
Capital expenditures	**$22.5**	**$10.5**	**$2.1**	**$5.9**	**$3.3**	**$2.2**	**$4.8**	**$7.5**	**$8.8**
Units	**6.0**	**8.0**	**10.0**	**10.0**	**10.0**	**11.0**	**12.0**	**15.0**	**20.0**
Company owned locations	6.0	8.0	10.0	10.0	10.0	11.0	11.0	13.0	15.0
Franchise locations	0.0	0.0	0.0	0.0	0.0	0.0	1.0	2.0	5.0

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Regarding the potential optionality embedded in the Bombshells concept, on the 1Q F2022 conference call RICK's chief executive commented that "We think for Bombshells it has to be taken seriously. $50 million is to us the magic number. That's when we have the option, the two-sided Bombshells could be a standalone entity or if Bombshells continues to fit into RCI, the way it currently — the current setup is or even looking at an acquirer that would be willing to pay us the big money for this fast growth restaurant chain." As part of the same discussion, Mr. Langan did not quibble with the assertion by a large investor, ADW Capital, the company's largest shareholder at ~9.55%, that Bombshells is currently worth ~$1 billion and could ultimately hit 100 locations, at which time, assuming ~$6.5 million in sales per unit, it would be a ~$200 million EBITDA business. In that context, on the 2Q F2022 earnings call, management indicated that they had "been offered by a group to roll into us (anecdotally, via a special purpose acquisition corporation or SPAC merger) back about eight months ago at about 14 times multiple. We look at that and said, okay, so we are doing $20 million you're going to give us $280 million in value for this. But we're going to grow this over the next three years to over $50 million, which would be $700 million. So where else can we earn $420 million in the next three years, almost guaranteed in value? So we decided to keep Bombshells in-house right now in the parent company. One of the things we do as we reach $50 million in EBITDA for Bombshells we could spin it off into a separate public company. We can go back and look at private equity groups again. In the next three years, we may see multiple expansion in RCI, which if we do maybe we just keep it in RCI. We don't rule anything out. I think people get confused, on what business we're in. And I say this a lot. We're not in the real estate business. We are not in the restaurant business. We're not even in the strip club business. We're in the free cash flow business." That said, "the reality is, we're going to do whatever is best for our shareholders and creating value for our shareholders over the long term."

Other

The Other segment (~1% of consolidated sales at ~$1.35 million in F2021) primarily generates sales from its media business ($1 million in F2021 versus $600,000 in F2020 and $1.4 million in F2019), and sales of Robust Energy drink (~$250,000 in F2021 compared with $150,000 in F2020 and ~$230,000 in F2019). On the media side, RICK owns a national industry trade publication (e.g., *Exotic Dancer Magazine)*, two national industry award shows (e.g., Exotic Dancers Expo, which is scheduled for August 14-17 in Las Vegas, NV), and more than a dozen industry-related social media websites. On the latter social media front, while we assign no value to any of RICK's "other" businesses, we think it worth noting the potential/upside call option stemming from the company's impending launch of AdmireMe.com, currently in beta testing, which is designed to be a competitor to OnlyFans.com. In addition to the potential financial upside, the site, in which RICK's total investment will be less than $1 million, is viewed as a vehicle to drive increased customer engagement and traffic to its "brick & mortar" clubs.

Balance Sheet and Cash Flow

At the end of 2Q F2022, RICK reported net debt of $140 million, including $38 million in cash and $178 million of debt, with net leverage and interest coverage ratios of ~1.8x and 6.3x, respectively. (See Background #6.) For context, roughly $120 million (or ~66.5% of the total debt load) of RICK's debt is secured by real estate (with a weighted average interest rate of 4.32%), while $34.5 million (or ~19.5% of the total) is comprised of seller financing secured by 13 clubs, with the remainder being unsecured debt (~10% of total debt) and secured debt (~4% of total debt). The total average weighted cost of debt was 6.14% at the end of 2Q F2022 (compared with 7.23% in 2Q F2017 and 6.78% in 2Q F2019 and 6.66% in 2Q F2021).

Background #6 RCI Hospitality: Balance Sheet Snapshot
($ in millions)

	F2018	F2019	F2020	F2021	2Q F2022
Cash	**$17.7**	**$14.1**	**$15.6**	**$35.7**	**$38.1**
Debt:					
Current portion	$19.0	$15.8	$16.3	$6.4	$11.2
Long-term debt	$121.6	$127.8	$125.1	$118.7	$166.9
Total	**$140.6**	**$143.5**	**$141.4**	**$125.2**	**$178.1**
Net debt	**$122.9**	**$129.4**	**$125.8**	**$89.5**	**$140.0**
Leverage ratio	3.2x	3.1x	6.3x	2.1x	2.3x
Leverage ratio, net	**2.8x**	**2.8x**	**5.6x**	**1.5x**	**1.8x**
Interest coverage ratio	2.8x	3.5x	0.3x	4.0x	6.3x
Interest coverage ratio, adj.	**2.8x**	**3.8x**	**1.5x**	**5.3x**	**6.3x**
Lease liabilities:					
Current lease liabilities	-	-	$1.6	$1.8	$2.3
Lease liabilities	-	-	$25.4	$24.2	$35.5
Total	**-**	**-**	**$27.1**	**$25.9**	**$37.8**
Equity:					
Stockholders equity	$153.4	$169.6	$152.7	$179.8	$228.0
Non-controlling interest	($0.1)	($0.2)	($0.4)	($0.6)	($0.6)
Total	**$153.3**	**$169.4**	**$152.3**	**$179.2**	**$227.4**

Source: Company reports, Bloomberg and Institutional Research Group estimates.

For F2022, the company projects maintenance capex of ~$6 million (compared with $5.9 million in F2021), and anecdotal commentary suggests adjusted free cash flow, calculated as cash flow from operations less maintenance capex, of $50-$60 million (see Background #13). As mentioned earlier, in a recent interview with Benzinga, Mr. Langan commented that the company should grow free cash flow by ~30% in F2022E (and said he thought, given the acquisition pipeline, that figure could be repeatable in F2023E). That said, the company's long-term goal targets compound annual free cash flow growth of 10%-15% (at minimum), with the CEO's personal goal being to generate a better than 20% CAGR (see Background #7).

Background #7 RCI Hospitality: Sources and Uses of Cash Flow
($ in millions, except per share amounts)

	F2018	F2019	F2020	F2021	6 mos. F2021	6 mos. F2022	F2022E	F2023E	F2024E
Net income	$21.0	$20.4	($6.3)	$30.2	$15.5	$21.5	$44.0	$41.4	$51.1
Depreciation & amortization	$7.7	$9.1	$8.8	$8.2	$4.1	$5.1	$10.6	$11.1	$11.8
Other	($2.9)	$7.7	$13.1	$3.6	($2.4)	$1.3	$2.5	$2.5	$2.5
Cash flow from operations	**$25.8**	**$37.2**	**$15.6**	**$42.0**	**$17.2**	**$27.9**	**$57.1**	**$55.0**	**$65.3**
Capital expenditures	**($25.3)**	**($20.7)**	**($5.7)**	**($13.5)**	**($6.7)**	**($14.0)**	**($28.1)**	**($30.4)**	**($33.5)**
Growth cap ex	($10.5)	($16.9)	($3.6)	($7.6)	($4.1)	($12.5)	($22.0)	($23.4)	($26.0)
Purchase of real estate	($12.3)								
Maintenance cap ex	($2.5)	($3.9)	($2.2)	($5.9)	($2.6)	($1.5)	($6.0)	($7.0)	($7.5)
Free cash flow (FCF)	$0.5	$16.5	$9.9	$28.5	$10.5	$13.9	$29.0	$24.7	$31.8
FCF, ex-growth cap ex	**$23.2**	**$33.3**	**$13.5**	**$36.1**	**$14.7**	**$26.3**	**$51.1**	**$48.0**	**$57.8**
FCF per share	$2.39	$3.45	$1.47	$4.01	$1.63	$2.79	$5.38	$5.06	$6.08
Proceeds from sale of assets	$0.8	$7.2	$2.2	$5.4	$0.0	$2.9	$10.6	-	-
Proceeds from insurance	$0.0	$0.1	$0.9	$1.2	$0.3	$0.5	$0.5	-	-
Acquisitions	($2.0)	($13.5)	-	-	-	($39.3)	($55.3)	($15.0)	($15.0)
Repurchases	-	($2.9)	($9.5)	($1.8)	($1.8)	($2.8)	($7.5)	($5.0)	($5.0)
Dividends	($1.2)	($1.3)	($1.3)	($1.4)	($0.7)	($0.9)	($1.9)	($1.9)	($1.9)
Non-controlling distributions	($0.2)	($0.1)	($0.0)	-	-	-	-	-	-

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Management, Ownership & Governance

RICK's Board is comprised of eight annually elected members, of which five are deemed independent, with the exception of chairman & chief executive Eric Langan, who owns ~7.5% of the outstanding shares, chief financial officer Bradley Chhay, and executive vice president (EVP) Travis Reese. Independent directors comprise the Audit, Nominating, and Compensation committees. All directors and officers, excluding Troy Lowrie's 5.3% ownership, collectively control ~8.1% of the outstanding shares. The largest individual shareholder is ADW Capital at ~9.55%, while the top 10 institutional shareholders collectively own ~35% of the outstanding shares (see Background #8). (While RCI does attract and communicate with institutional investors the company has markedly increased its outreach to the retail investment community in recent quarters by, among other things, having management be active on social media as well as hosting quarterly conference calls and debate forums on Twitter Spaces. Notably, RICK was a pioneer in utilizing the Spaces platform to communicate with investors and the most recent 2Q F2022 earnings call attracted ~600 attendees compared with the company's previous record of ~175 listeners using the traditional methods.)

As a point of information, in September 2020 RICK paid a $400,000 fine to settle, without admission or denial, charges levied by the Securities and Exchange Commission (SEC); as well, current chief executive, Eric Langan, and former chief financial officer, Phillip Marshall, agreed to pay, again without admitting or denying the charges, civil penalties of $200,000 and $35,000, respectively. The SEC's charges stemmed from the alleged failure to disclose (and internally control) $615,000 in executive compensation (over the five years between F2014-F2019), including the cost of personal use of the company's aircraft and vehicles, as well as reimbursement for personal airfare, charitable donations, and housing and meal costs. (As we understand it, the issue was not that the items in question were not accounted for, but rather that they were accounted for improperly/insufficiently.) Earlier, in September 2020, Mr. Marshall, then 70 years old, was succeeded as CFO by Bradley Chhay as part of a planned transition. (Previously, Mr. Chhay had been the company's controller since 2015.) Additionally, the company is in the process of remediating a material weakness in its internal controls, related to its tax provision accounting, which are "non-cash estimates that come up as accrual entries", that should be completed shortly.

Background #8 RCI Hospitality: Current Top 20 Shareholders of RICK

	Shares held	% ownership
Holders:		
ADW Capital Management	0.9	9.6%
Eric Langan	0.7	7.5%
BlackRock Inc.	0.5	5.8%
Troy Lowrie	0.5	5.3%
The Vanguard Group	0.4	4.3%
Dimensional Fund Advisors	0.4	4.2%
Cooper Capital Management	0.3	3.4%
Prudential Financial	0.2	1.9%
State Street	0.2	1.7%
Geode Capital Management	0.1	1.6%
Scholtz & Co.	0.1	1.3%
Goldman Sachs Group	0.9	1.0%
Northern Trust	0.9	1.0%
Citadel Advisors	0.7	0.7%
Bank of America	0.7	0.7%
Resolute Capital Partners	0.6	0.6%
JB Capital Partners	0.6	0.6%
Deutsche Bank	0.5	0.6%
J Goldman & Co.	0.5	0.5%
Bank of New York Mellon	0.5	0.5%
Total	**10.3**	**52.9%**
Insiders:		
All executives & directors (8 people)	**2.7**	**8.1%**

Source: Company reports, Bloomberg.

The Breakdown

Based on the assumptions discussed throughout this report, we think it can be reasonably projected that RICK could generate F2024E (September-ending) sales and adjusted EBITDA of $317 million and $89.3 million, respectively (see Breakdown #1). While no consensus estimates exist for F2024, our F2023E sales and adjusted EBITDA forecasts of $286 million and $76 million compare with current consensus of $291.5 million and $91.3 million, respectively.

Breakdown #1 RCI Hospitality: Adjusted F2018-F2021 Results and F2022-F2024 Forecasts
($ in millions)

	F2018	F2019	F2020	F2021	F2022E	F2023E	F2024E
Sales:							
Nightclubs	$140.1	$148.6	$88.4	$137.3	$214.3	$210.3	$227.5
Bombshells	$24.1	$30.8	$43.2	$56.6	$63.8	$74.1	$88.0
Other	$1.6	$1.6	$0.7	$1.3	$1.4	$1.4	$1.5
Total	**$165.7**	**$181.1**	**$132.3**	**$195.3**	**$279.4**	**$285.8**	**$317.0**
Income from operations:							
Nightclubs	$43.6	$50.7	$13.1	$43.8	$77.5	$72.8	$82.6
Bombshells	$2.0	$2.3	$9.2	$13.3	$13.9	$16.3	$20.0
Other	($0.3)	($0.3)	($0.6)	$0.0	($0.2)	($0.2)	($0.2)
Corporate	($17.9)	($18.0)	($18.9)	($18.6)	($23.8)	($24.3)	($24.8)
Total	**$27.6**	**$34.7**	**$2.7**	**$38.5**	**$67.5**	**$64.6**	**$77.5**
Ad. income from operations:							
Nightclubs	$43.6	$53.5	$23.6	$56.1	$77.8	$72.9	$82.7
Bombshells	$2.0	$2.3	$9.5	$13.4	$13.9	$16.3	$20.0
Other	($0.3)	$0.1	($0.2)	$0.1	($0.2)	($0.2)	($0.2)
Corporate	($17.9)	($18.0)	($19.0)	($17.6)	($24.0)	($24.3)	($24.8)
Total	**$27.6**	**$37.9**	**$13.9**	**$52.0**	**$67.6**	**$64.8**	**$77.7**
Depreciation & amortization:							
Nightclubs	$5.4	$6.4	$5.8	$5.5	$7.8	$8.0	$8.3
Bombshells	$1.3	$1.4	$1.8	$1.8	$1.9	$2.2	$2.5
Other	$0.2	$0.4	$0.4	$0.1	$0.0	$0.0	$0.0
Corporate	$0.9	$0.9	$0.8	$0.8	$0.8	$0.9	$1.0
Total	**$7.7**	**$9.1**	**$8.8**	**$8.2**	**$10.6**	**$11.1**	**$11.8**
EBITDA:							
Nightclubs	$49.0	$57.1	$18.9	$49.3	$85.3	$80.8	$90.8
Bombshells	$3.3	$3.7	$11.0	$15.1	$15.8	$18.6	$22.5
Other	($0.1)	$0.1	($0.2)	$0.1	($0.2)	($0.2)	($0.2)
Corporate	($17.0)	($17.1)	($18.1)	($17.7)	($22.9)	($23.4)	($23.9)
Total	**$35.3**	**$43.8**	**$11.6**	**$46.8**	**$78.1**	**$75.7**	**$89.3**
Adjusted EBITDA:							
Nightclubs	$49.0	$59.9	$29.4	$61.6	$85.6	$80.9	$91.0
Bombshells	$3.3	$3.7	$11.3	$15.2	$15.8	$18.6	$22.5
Other	($0.1)	$0.5	$0.2	$0.2	($0.2)	($0.2)	($0.2)
Corporate	($17.0)	($17.1)	($18.1)	($16.7)	($23.1)	($23.4)	($23.9)
Total	**$35.3**	**$47.0**	**$22.7**	**$60.3**	**$78.2**	**$75.9**	**$89.5**
Adjusted EBITDA (as reported)	$44.4	$46.2	$22.4	$60.2	$78.2	$75.9	$89.5
Capital expenditures:							
Nightclubs	$2.1	$6.6	$3.5	$6.9	$21.4	$21.0	$22.7
Bombshells	$22.5	$10.5	$2.1	$5.9	$4.8	$7.5	$8.8
Other	$0.0	$0.0	$0.0	$0.2	$1.0	$1.0	$1.0
Corporate	$0.7	$3.6	$0.1	$0.6	$0.8	$0.9	$1.0
Total	**$25.3**	**$20.7**	**$5.7**	**$13.5**	**$28.1**	**$30.4**	**$33.5**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

HIDDEN OPPORTUNITIES

Breakdown #2 RCI Hospitality: Public Comparables

($ in millions, except per share amounts; shares in millions)

6/29/2022	RCI Hospitality Holdings Inc	Madison Square Garden Entertainment Corp	AMC Entertainment Holdings Inc	Six Flags Entertainment Corp	Cedar Fair LP	Penn National Gaming Inc	Life Time Group Holdings Inc	Cracker Barrel Old Country Store Inc	Darden Restaurants Inc	Denny's Corp	Dine Brands Global Inc	Texas Roadhouse Inc
Ticker	RICK	MSGE	AMC	SIX	FUN	PENN	LTH	CBRL	DRI	DENN	DIN	TXRH
Price	$48.46	$52.30	$13.65	$21.97	$43.40	$31.14	$13.16	$84.52	$113.87	$8.93	$65.15	$74.20
Shares Out	9.4	27.3	516.8	86.4	57.0	166.8	193.7	22.8	124.7	61.7	16.8	68.2
M Cap	456.3	1,789.3	7,054.6	1,899.2	2,475.6	5,194.2	2,549.5	1,926.1	14,203.5	551.1	1,091.3	5,058.1
Net Debt	139.4	803.6	4,425.7	2,901.1	2,597.1	10,099.7	1,788.6	348.1	480.4	174.1	1,057.4	(210.2)
EV	595.7	2,592.9	11,480.3	4,800.3	5,072.7	15,313.3	4,338.1	2,274.2	14,683.9	725.2	2,148.7	4,847.8
Revenue												
2021E	195.3	147.6	2,441.6	1,448.1	1,288.1	5,844.2	1,314.8	2,830.4	7,103.9	403.1	902.6	3,463.5
2022E	279.4	1,681.7	4,400.4	1,686.5	1,864.4	6,374.3	1,876.3	3,277.7	-	440.9	944.1	3,982.2
2023E	285.8	1,885.6	5,244.3	1,748.2	1,927.9	6,606.5	2,326.5	3,398.7	10,305.2	449.6	981.9	4,330.6
2024E	317.0	2,317.3	5,373.8	1,812.7	1,980.4	7,015.2	2,572.0	3,523.2	10,915.0	449.0	992.3	4,719.7
CAGR	*17.5%*	*150.4%*	*30.1%*	*7.8%*	*15.4%*	*6.3%*	*25.1%*	*7.6%*	-	*3.7%*	*3.2%*	*10.9%*
EV / Sales												
2021E	3.0x	17.6x	4.7x	3.3x	3.9x	2.6x	3.3x	0.8x	2.1x	1.8x	2.4x	1.4x
2022E	2.2x	1.5x	2.6x	2.8x	2.7x	2.4x	2.3x	0.7x	-	1.6x	2.3x	1.2x
2023E	2.0x	1.4x	2.2x	2.7x	2.6x	2.3x	1.9x	0.7x	1.4x	1.6x	2.2x	1.1x
2024E	1.9x	1.1x	2.1x	2.6x	2.6x	2.2x	1.7x	0.6x	1.3x	1.6x	2.2x	1.0x
Average		*2.1x*						*1.4x*				
EBITDA												
2021E	60.2	(256.5)	(368.3)	470.6	306.8	1,984.2	79.0	280.0	992.2	83.5	247.6	417.1
2022E	78.2	10.6	282.6	607.2	630.4	1,963.3	298.6	270.7	-	81.8	241.8	470.8
2023E	75.9	209.5	594.8	641.5	660.3	2,046.6	473.5	292.6	1,567.2	91.7	256.8	546.6
2024E	89.5	271.7	673.0	694.8	686.0	2,227.9	520.8	307.6	1,688.0	73.0	264.0	611.2
Margin	*28.2%*	*11.7%*	*12.5%*	*38.3%*	*34.6%*	*31.8%*	*20.3%*	*8.7%*	*15.5%*	*16.3%*	*26.6%*	*13.0%*
EV / EBITDA												
2021E	10.9x	-	-	10.2x	16.5x	7.7x	54.9x	8.1x	14.8x	8.7x	8.7x	11.6x
2022E	7.6x	-	40.6x	7.9x	8.0x	7.8x	14.5x	8.4x	-	8.9x	8.9x	10.3x
2023E	7.8x	12.4x	19.3x	7.5x	7.7x	7.5x	9.2x	7.8x	9.4x	7.9x	8.4x	8.9x
2024E	6.7x	9.5x	17.1x	6.9x	7.4x	6.9x	8.3x	7.4x	8.7x	9.9x	8.1x	7.9x
Average		***9.4x***						***8.4x***				
EPS												
2021E	$3.37	($15.91)	($2.73)	$1.44	($0.80)	$2.71	($1.96)	$5.21	$4.05	$0.54	$6.51	$3.45
2022E	$4.63	($3.04)	($1.11)	$2.64	$4.08	$1.66	($0.29)	$5.93	-	$0.57	$6.07	$3.96
2023E	$4.36	$0.39	($0.38)	$2.90	$4.37	$2.41	$0.34	$6.55	$7.75	$0.68	$7.13	$4.80
2024E	$5.37	$1.77	($0.15)	$3.43	$4.54	$3.42	$0.52	$6.81	$8.59	$0.59	$8.27	$5.60
P/E												
2021E	14.4x	-	-	15.2x	-	11.5x	-	16.2x	28.1x	16.6x	10.0x	21.5x
2022E	10.5x	-	-	8.3x	10.6x	18.8x	-	14.2x	-	15.6x	10.7x	18.7x
2023E	11.1x	-	-	7.6x	9.9x	12.9x	39.1x	12.9x	14.7x	13.1x	9.1x	15.5x
2024E	9.0x	29.6x	-	6.4x	9.6x	9.1x	25.6x	12.4x	13.3x	15.1x	7.9x	13.3x
Average		*16.0x*						*12.4x*				

Source: Company reports, Bloomberg, and Institutional Research Group estimates

Institutional Research Group

Nightclubs

While no clear public peers exist for RICK's Nightclubs business, it can be imperfectly compared with a range of entertainment concerns, including MSG Entertainment (NYSE: MSGE), AMC Entertainment (NYSE: AMC), Six Flags Entertainment (NYSE: SIX), Cedar Fair (NYSE: FUN), Penn National Gaming (NASDAQ: PENN) and Life Time Group (NYSE: LTH), which trade at ~9.5x 2024E EV/EBITDA (see Breakdown #2). Recent M&A in the broad entertainment facility sector has averaged ~10.5x (see Breakdown #3).

Breakdown #3 RCI Hospitality: Entertainment Facility Sector M&A, Selected Items
($ in millions)

Announced	Acquirer	Target	EV	EV/EBITDA multiple
Apr-22	Dave & Buster's	Main Event	$835.0	9.0x
Sep-21	MSG Entertainment	Tao Hospitality Group	$300.0	10.9x
Dec-19	Cineworld	Cineplex	$4,153.0	10.4x
Jun-19	Blackstone	Merlin Entertainment	$6,828.0	11.9x
May-19	NASCAR Holdings	International Speedway	$1,939.0	9.9x
Apr-19	EQT Partners	Parques Reunidos Servicios	$2,320.0	11.7x
Dec-17	Cineworld	Regal Entertainment	$5,876.0	9.0x
Apr-17	Aspen Skiing Co.	Alterra Mountain	$1,408.0	10.7x
Mar-16	AMC Entertainment	Carmike Cinemas	$1,124.0	8.2x
Aug-16	Vail Resorts	Whistler Blackcomb	$1,591.0	11.9x
Mar-15	TPG Capital	Life Time Inc.	$4,059.0	9.8x
Avg.				**10.4x**

Source: Company reports, Bloomberg, Chain Bridge Research, and Institutional Research Group estimates.

Applying a discounted multiple of 8.5x to F2024E adjusted EBITDA of $91 million yields a base case segment value of $773.5 million, or roughly $81 per share (see Breakdown #4).

Breakdown #4 RCI Hospitality: Estimated Value of Nightclubs Segment Based on F2024E EBITDA
($ in millions, except per share amounts; shares in millions)

		Nightclubs	
F2022E Revenue		$214.3	
Revenue growth est.		-1.9%	
F2023E Revenue		$210.3	
Revenue growth est.		8.2%	
F2024E Revenue		**$227.5**	
EBITDA margin		40.0%	
F2024E EBITDA		**$91.0**	
Applied multiple	6.5x	**8.5x**	10.5x
Enterprise value	$591.5	**$773.5**	$955.6
Diluted shares	9.5	9.5	9.5
Per share basis	$62.27	**$81.43**	$100.58

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Bombshells

In terms of publicly traded peers, RICK's Bombshells business could be compared with Cracker Barrell Old Country Store Inc. (NASDAQ: CBRL), Darden Restaurants (NASDAQ: DRI), Denny's Corp. (NASDAQ: DENN), Dine Brands (NYSE: DIN), and Texas Roadhouse (NASDAQ: TXRH), which trade at ~8.5x 2024E EV/EBITDA (see Breakdown #2). Recent M&A in the broad restaurant sector has averaged ~12.5x (see Breakdown #5).

Breakdown #5 RCI Hospitality: Restaurant Sector M&A, Selected Items
($ in millions)

Announced	Acquirer	Target	EV	EV/Revenue multiple	EV/EBITDA multiple
Sep-21	FAT Brands	Twin Peaks	$300.0	0.8x	10.9x
Jun-21	FAT Brands	Global Franchise Group	$442.5	-	9.8x
Oct-20	Inspire Brands	Dunkin Brands	$11,584.0	-	23.5x
Mar-19	TriArtisan & Paulson	P.F. Chang's	~$700	1.4x	11.7x
Nov-19	Allegro	TGI Friday's	$448.0	~0.2x	~8.0x
Nov-19	ICV Partners	Diversified Restaurant Holdings	$308.0	-	13.9x
Jul-19	Vintage Capital	Red Robin	$1,205.0	-	11.1x
Jun-19	Catterton	Del Frisco's	$823.7	1.6x	19.0x
Nov-18	Jordan Co.	Bojangles' Inc.	$713.0	-	11.9x
Sep-18	Inspire Brands	Sonic Corp.	$2,234.0	-	15.1x
Feb-18	Rhone Capital	Fogo de Chao	$546.0	-	9.5x
Mar-17	Darden Restaurants	Cheddar's Casual Café	$810.0	-	10.4x
Nov-17	Arby's/Inspire Brands	Buffalo Wild Wings	$2,900.0	1.4x	10.2x
Apr-17	JAB Holdings	Panera Bread Co.	$7,563.0	-	17.1x
Sep-14	Greene King PLC	Spirit Pub Co. Ltd.	$1,415.0	-	8.8x
Aug-14	Burger King	Tim Hortons Inc.	$14,624.0	-	16.0x
Sep-14	J. Alexander's	American Blue Ribbon	$100.0	-	8.8x
May-14	Sentinel/Tri-Artisan Capital	TGI Friday's	$800.0	-	8.0x
Jul-12	Darden Restaurants	Yard House USA	$585.0	-	14.9x
May-12	Angelo, Gordon & Co.	Benihana	$290.0	-	8.0x
Avg.				**1.3x**	**12.5x**

Source: Company reports, Bloomberg, Chain Bridge Research, and Institutional Research Group estimates.

Applying a 12.5x multiple to F2024E adjusted EBITDA of ~$22.5 million yields a base case segment value of roughly $281 billion, or ~$30 per share (see Breakdown #6). For context, we note that this fair value estimate is roughly in line with the valuation that was already offered for Bombshells (but rejected) by the financial sponsor of a special purpose acquisition corporation (SPAC) in mid-2021.

Breakdown #6 RCI Hospitality: Estimated Value of Bombshells Segment Based on F2024E EBITDA

($ in millions, except per share amounts; shares in millions)

		Bombshells	
F2022E Revenue		$63.8	
Revenue growth est.		16.1%	
F2023E Revenue		$74.1	
Revenue growth est.		18.8%	
F2024E Revenue		**$88.0**	
EBITDA margin		25.5%	
F2024E EBITDA		**$22.5**	
Applied multiple	10.5x	**12.5x**	14.5x
Enterprise value	$236.2	**$281.1**	$326.1
Diluted shares	9.5	9.5	9.5
Per share basis	$24.86	**$29.59**	$34.33

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Accounting for projected net debt, including minority interest, of ~$128 million, yields a sum-of-the-parts valuation of roughly $704 million, or roughly $74 per share (see Breakdown #7).

Breakdown #7 RCI Hospitality: Sum-of-the-Parts Fair Value Estimate

($ in millions, except per share amounts; shares in millions)

	Nightclubs	Bombshells	Corporate & Other	Enterprise Value	Net Debt	Market Cap
F2023E Revenue	**$210.3**	**$74.1**				
Revenue growth est.	8.2%	18.8%				
F2024E Revenue	**$227.5**	**$88.0**				
EBITDA margin	40.0%	25.5%				
F2024E EBITDA	**$91.0**	**$22.5**	**($24.0)**		**($127.9)**	
Applied multiple	**8.5x**	**12.5x**	**9.3x**		**1.0x**	
Enterprise value	**$773.5**	**$281.1**	**($223.1)**	**$831.6**	**($127.9)**	**$703.6**
Diluted shares	9.5	9.5	9.5		9.5	9.5
Per share basis	**$81.43**	**$29.59**	**($23.49)**		**($13.46)**	**$74.07**
Bull	$100.58	$34.33	($26.02)		($13.46)	$95.43
Base	$81.43	$29.59	($23.49)		($13.46)	$74.07
Bear	$62.27	$24.86	($20.96)		($13.46)	$52.70

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

The Wrap-Up

In our view, RICK, which, on a consolidated basis, targets compound annual free cash flow per share (FCF) growth of 10%-15% (at minimum), is, at ~6.5x F2024E EBITDA and a FCF yield of ~12.5%, undervalued relative to the sum value of its parts. On the fundamental front, in pursuit of its aforementioned FCF goals, RICK has said that it will further consolidate the Nightclub business, which enjoys structural barriers to entry and generates high margins with durable cash flow, at 3x-5x EBITDA (and cash-on-cash returns of 25%-33%), as well as organically expand its Bombshells sports bar concept, via both company-owned and franchised locations (again, targeting cash-on-cash returns of 25%-33%). In addition, RICK will repurchase shares when its FCF yield exceeds 10%. On the transaction front, we think RICK's Bombshells concept presents optionality for a spin-off or sale as it gains incremental scale toward ~$50 million of annual EBITDA. (In fact, management has anecdotally indicated that a financial sponsor offered ~14x or ~$280 million for Bombshells in mid-2021, but the Board concluded the transaction was premature and offered inadequate value.)

Based on management commentary as well as peer and M&A valuations, value of $81 per share and $30 per share can be assigned to RICK's Nightclubs and Bombshells businesses, respectively. Accounting for projected net debt, including minority interest, and corporate costs of ~$37 per share yields a base case sum-of-the-parts fair value of ~$74 per share (with bull and bear cases of $52.50 and $95.50, respectively).

Potential catalysts include a spin-off or sale, better than expected growth/margins/FCF, stock buybacks, and/or acquisitions. Potential risks include execution, regulatory changes, including on employment classifications, zoning and liquor licenses, cost inflation, consumer behavior changes, insurance liability, a pandemic, and/or a recession.