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Transcript of
RCI Hospitality Holdings, Inc.
Third Quarter 2017 Earnings Call and Webcast
August 9, 2017

Participants

Eric Langan - President and CEO
Gary Fishman - Investor Relations

Analysts

Frank Camma - Sidoti & Company
Marco Rodriquez – Stonegate Capital
Mike Mork – Mork Capital Management
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Steve Martin – Slater Capital Management
Bill Brown – Private Investor

Presentation

Operator
Good day, ladies and gentlemen. Welcome to RCI Hospitality Holdings, Inc. Fiscal 2017 Third Quarter Conference Call and Webcast. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. As a reminder, this conference is being recorded.

It is now my pleasure to introduce Gary Fishman who handles Investor Relations for RCI. Sir, the floor is yours.

Gary Fishman – Investor Relations
Thank you, Kat. Please, everybody, if you could turn to Slide 2. I want to remind you of our Safe Harbor statement that is posted at the beginning of our conference call presentation. It reminds you that you may hear or see forward-looking statements that involve a number of risks and uncertainties. I urge you to read it. Actual results may differ materially from those currently anticipated. We disclaim any obligation to update information disclosed in this call as a result of developments that occur afterwards.

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

Finally, I'd like to invite everyone in the New York City area to join us tonight at six o'clock to meet management at Rick's Cabaret New York, Manhattan's number one gentlemen's club. You can also tour its sister club, Hoops Cabaret and Sports Bar next door. Rick's Cabaret is located at 50 West 33rd Street between 5th Avenue and Broadway, and it's around the corner from the Empire State Building. If you haven't RSVP'd, ask for me at the door.

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

Eric Langan – President and CEO
Thank you, Gary. Good afternoon, everyone. Please turn to Slide 4. After the market closed, we announced our third quarter results for fiscal 2017. We had a strong quarter. This was especially impressive given that this

period is normally a weaker quarter. EPS of $0.40 was up 48% year-over-year. On a non-GAAP basis, EPS of $0.47 was up 38%. Total revenues were $37.4 million, up more than 10%.

This primarily reflects a combination of increased same-store sales and acquisitions. Same-store sales were up 6.8%. This was one of the largest quarterly increases in the last five years. Our two acquisitions, in for only part of the quarter, added more than $2 million in revenues. Margins expanded, too. Gross profit at 85.9% increased 148 basis points, while GAAP operating margin at 21.1% expanded 145 basis points, and non-GAAP operating margin at 23.6% grew 283 basis points.

Looking at free cash flow, we are now at $16.6 million as of the nine months. That puts us on track to exceed our initial fiscal year 2017 target of $18 million. On the last call, we promised to update you on our free cash flow projections. Based on the combination of our organic performance and now three months of our new acquisitions, our initial target going into fiscal 2018 is $21 million. That's up 17% over our initial target for this fiscal year.

Two other things. As we reported in June, RCI was added to the Russell 2000 and 3000 Indexes. We are proud to have accomplished this for our shareholders. It should also add to our ongoing effort to increase the visibility and shareholder base of our stock. In July, we named BDO as our auditors. BDO is among the top six national auditing firms. It is also one of the few in the US with a robust and dedicated restaurant practice.

Please turn to Slide 5. Before I continue, I'd like to take a moment to review our business strategies. Regarding nightclubs, our strategy is to acquire more of the industry's best clubs, such as Scarlett's Cabaret Miami, and develop some of our own properties when and where possible. We believe the gentlemen's club business, the way we operate it, has tremendous financial advantages. High margin VIP revenues, high beverage inventory turns, and low capex enable us to generate high amounts of cash flow.

We estimate there are 3,500 clubs in the US. About 500 would meet our qualifications. While we are now one of the largest entities in the industry, our market share is probably no more than 2%. That gives us plenty of space to expand. Many owners are of an age where they're interested in selling. As the only publicly traded company in the industry, and the only entity with significant access to bank financing, we are the acquirer of choice.

We target properties that we can buy at three to four times adjusted EBITDA and are earnings accretive. In doing this, we prefer using debt financing, including seller financing funded by the cash flow from the operations.

Regarding Bombshells, access to bank financing has significantly increased the potential for greater cash-on-cash returns. Based on industry dynamics, we believe Bombshells has a potential to grow into a chain of 80 to 100 units with about 80% franchise and 20% company owned.

The concept has demonstrated a wider appeal than competitor brands. It attracts men, women, singles, couples, families, of all ages and all backgrounds, from Millennials to seniors. We do a strong business through the day and night, and the beverage to food ratio is about 60%/40%. This compares to a more general restaurant industry average of 15% to 30% for beverage and 70% to 85% for food.

Ultimately, as we continue to perform and deliver, our goal for these business strategies based on our capital allocation strategy is to increase free cash flow per share 10% to 15% a year and expand our multiple.

Please turn to Slide 6 for a discussion of our capital allocation strategy. We've updated our graph a little differently this quarter to give you a visual representation of the progress we've made over the past couple of years. The graph is now showing you free cash flow return on our market capitalization using our new $21 million projection in green, our former $18 million projection in red, and our original $15 million projection in blue going back to when we initiated our capital allocation strategy.

To demonstrate the progress we've made, look at the black horizontal line. At $21 million in free cash flow and a $23 stock price, we have a yield of 9.4%. Looking back, that's the same yield based on $15 million of free cash flow and a $16 stock price. That increase in our projections over the years reflects a combination of what's happened with our free cash flow and the decline in share count since we launched the program. As we continue to grow free cash flow and/or buyback shares, our goal is to keep working at generating the best possible return, and if we're successful, we'll keep shifting this curve to the upside.

Our cash-on-cash target for buying or opening new units is 25% to 33%. So at this time, our strategy is still leaning towards new units. However, we are only looking for very select types of acquisitions that fit our capital allocation model as well as fit strategically within our management capabilities.

Please turn to Slide 7 for an update on our nightclub activities. We were very busy during this quarter and after the quarter. Our two recent acquisitions, Scarlett's Cabaret Miami and Hollywood Show Club in Greater St. Louis, performed in line with expectations.

Subsequent to the quarter, we launched the St. Louis Club as a Scarlett's Cabaret with good success so far. We also opened the unused club property we'd acquired in the Greater St. Louis area as in Hollywood Hunt Club. This is being operated through a joint venture in which we own 51%. Minimal additional capital is required for both of these ventures in St. Louis.

In Houston, we opened a Studio 80 dance club, which is also performing in line with expectations. After trying a couple times to reformat our property in Dallas in line with our capital allocation strategy, we closed the club, took an impairment charge, and have put it up for sale. We also sold a parcel of non-income producing property, proceeds were in line with expectations, and we paid down related 9.5% debt and recorded a gain on the transaction.

Please turn to Slide 8 for an update of our Bombshells activity. We've also had a very busy quarter here. After an intense amount of personnel training, we opened our latest unit in Northwest Houston on July 17th. To date, it is performing well with three back-to-back $100,000 plus weeks. *Nation's Restaurant News*, a leading industry trade publication, recently wrote it up. The headline was great, "Bombshells Chain Fuses Food and Entertainment."

We've also broke ground on the next Bombshells in Pearland. That's a fast growing suburb on the southern border of Houston. We entered into a bank loan agreement for construction and to refinance the real estate. Our timetable calls for opening this unit by the end of the first quarter of fiscal 2018. We are actively developing another property along I-10 in Houston, and we are looking at opening this by the third quarter of fiscal 2018. We are also scouting three more units that would give us a total of ten company stores.

Now, let's breakdown the quarter's performance. Please turn to Slide 9. Sales trends were very good. As I mentioned, same-store sales were up 6.8%. Sales from new units including acquisitions were up 10.3%. As a result, total club and restaurant sales were up 11.5%. All core revenue lines—service, beverage, and food—increased year-over-year and sequentially. In particular, high margin service revenues were up 8.3% sequentially and 20.1% year-over-year.

Please turn to slide 10. Margins are expanding. Gross profit margins climbed 85.9% of revenues with an increase in service revenues. Non-GAAP operating margin hit 23.6% due to increased operating leverage. While expenses were up in dollars, they fell as a percentage of revenues. The dollar increases were due to adding the new acquisitions, pre-opening costs for the new Bombshells, lower depreciation and amortization with non-income producing properties up for sale, and the goodwill impairment which was partially offset by the gains.

Please turn to Slide 11. Our nightclub segment did very well. The numbers on this slide speak for themselves. We have seen a broad based recovery in VIP spend and in customer accounts, which was of course aided by our acquisitions.

Please turn to Slide 12. Here are our segment results for Bombshells. Total revenues were down because of the unit we closed in the fourth quarter of '16. However, average sales per unit ran at \$1.15 million. That's up 15.2% year-over-year. Operating margins declined primarily due to the new Bombshells pre-opening costs. This included the cost of developing and implementing new training programs. Otherwise, margins would have been comparable to the second quarter and the year-ago quarter.

On the franchise front, we've continued to meet with very qualified leads and giving them tours of our units. The reception continues to be favorable, but we don't want to rush it. The first franchises awarded for new concepts are very important, and we want to do this right.

Please turn to Slide 13. This slide reviews our cash generating ability. I've already reviewed our free cash flow situation. I'd like to note, the adjusted EBITDA increased nearly 22% to more than \$10 million. This is the highest level in the last seven trailing quarters. Cash was down a little from March 31st, largely due to the all-cash acquisitions in St. Louis.

Please turn to Slide 14. Here's our long-term debt slide. There are three major changes from the last quarter. We added \$5.4 million in parent-level debt related to Scarlett's acquisition. That's the unsecured debt we mentioned on the last call. We now have a \$20.5 million dollar slice representing the Scarlett's seller financing. Jaguar seller financing fell \$2.1 million primarily due to the sale of non-incoming producing property and the normal amortization. Net/net total long-term debt increased \$22.9 million from March 31st with a relatively minor 14 basis point increase in the average weighted rate.

Please turn to Slide 15. Here is our debt maturity schedule as of June 30th. We have two realty balloons coming up over the next three years. In fiscal 2018, a \$2 million balloon should convert into a construction loan for our Bombshells I-10 location, and in fiscal 2020, there's a \$19.4 million balloon. A majority of it is related to Tootsie's, which we expect to be able to refinance or extend.

There are a few other changes on the schedule. Fiscal 2017 is lower primarily due to the 9.5% note we paid down. In fiscal 2018, we have a \$5 million piece of Scarlett's seller financing. In fiscal 2020, we have \$5.4 million of parent-level debt related to Scarlett's, and the balance of Scarlett's seller financing amortizes over 12 years. You can see that the maturities continue to be manageable with annual debt amortization ahead ranging from \$6.5 million to \$9.9 million.

I'd like to note that we are exploring the possibility of a \$75 million to \$85 million bank consolidation loan. Our goal is for the rate to be under 6% for 20 years with a ten-year balloon. We'd like to roll up as many of our current loans and consolidate them into a single payment.

Please turn to Slide 16. Our outlook continues to be strong. The fourth quarter will see a full quarter of Scarlett's Miami. Keep in mind, this is normally a seasonally soft period for the nightclub business. The first quarter of fiscal 2018 will see a full quarter of our new Bombshells. Although smaller, the first quarter will also see a full quarter of our rebranded Scarlett's St. Louis and the Hollywood Hunt Club.

Looking further out, the second quarter of fiscal 2018, which is normally a seasonally strong quarter to begin with, could benefit from two events. In New York City, the Grammy's will be held in January at Madison Square Garden for the first time. That's near where we have three very popular clubs. In Minneapolis, the Super Bowl will be held in February at the new downtown stadium for the first time, also near three of our popular clubs there.

Looking at free cash flow, as I noted earlier, we expect to exceed our fiscal 2017 target of $18 million and our initial target for fiscal 2018 is $21 million. On behalf of RCI Management and our subsidiaries, I'd like to thank our loyal shareholders for their support.

Let's open the line for questions. Operator?

Operator
Thank you. The floor is now open for questions. [Operator instructions.]

Our first question comes from Frank Camma from Sidoti. Go ahead, Frank.

Q: Good afternoon, guys. Thanks for taking my call. Could you talk a little bit about, on the nightclub side, it looks like very strong same-store sales here. It's hard to believe that it's even getting better from here, but can you talk a little bit about the regulatory environment, specifically in New York City. I know you have some specifics there and in Florida that might further benefit the competitive landscape.

Eric Langan – President and CEO
There were a couple of clubs in Florida that were sunsetted that have closed that helped us a little bit in that market. I don't know that there's going to be a whole lot more in that market but we'll see. Most of the operations there now are in pretty good shape.

As far as New York goes, the courts have ruled the 60%/40% is no longer a viable workaround. It doesn't affect us in any of our operations as all of our operations are 100% legal locations. So basically it's the 60%/40% operators, they've got some time to try to work through the courts. I don't, personally, suspect that they're going to get a lot of relief from the courts at this point. It's been going on for about 20 years. I think it's about played out. We've never invested in 60%/40% locations for this exact reason. My belief was always that at some point, those locations would have to close, which is why we invested in 100% locations.

We'll see what happens I guess. I think the 90-day period to apply to the Supreme Court is in September some time, and then we'll see if the Supreme Court gives them a stay or not. We just won't know until that time.

Q: Okay. The potential bank deal that you mentioned. Would that be collateralized by some of your clubs? How would that work or would that be a subordinate note?

Eric Langan – President and CEO
It would be a complete real estate mortgage. Basically, we take all of our real estate and combine it into a single mortgage instead of having – like right now I think we have about 29 payments. So the idea is to get rid of 29 individual payments and put it into a single. Plus, some of our amortization schedules are shorter, our interest rates are higher, so I think we would save money on interest. We'd definitely save money on time only having to pay one payment a month instead of 29. And the amortization schedule would change drastically, because the shorter amortizations would then go into the new 20-year amortization, so it would help alleviate the use of our free cash flow for debt service and give us a lot of ability to grow.

Q: Great. The small Dallas club, that was the club that basically was structured, it was only open, if I remember right, a couple days a week or maybe four days a week. Am I correct? Is that the club I'm thinking of?

Eric Langan – President and CEO
Yes, well there's a couple out there, so I don't know exactly which one you're talking about, but yes, the one we closed was open five days a week actually but it's only been open for about seven weeks. We just decided that in the long run, we've tried a couple different concepts there. With Miami on our plate and St. Louis on our plate, we want to keep our management focus there. The property is worth well more than book value just based on the appraised value not even to mention the adult use.

We are putting it out on the market. We have several parties that are interested that I'll be meeting with over the next few weeks, and I'm hoping that we can arrange a sale on that property relatively quickly and at a profit over book value.

Q: So you may actually recapture some of this $1.4 million, no?

Eric Langan – President and CEO
Yes, we may. Unfortunately, the way that GAAP works, we have to write-off everything that has to do with operations, but you don't get to write-up the real estate. It's on a little over 10 acres of property, maybe 11 acres of property there, right off Northwest Highway, so it can be used as a regular nightclub. It's a huge building, about 28,000 square feet, so there are a lot of additional uses. I don't know that an adult club was the best use for the property at this time.

I will say the people that are looking are adult club operators, and they want to go in there and give it a shot and try a different concept. We're more than willing to sell them the property at this time.

Q: My last question and I'll let somebody else, on Bombshells, how does the initial opening the first couple of weeks here compare to your other experiences so far?

Eric Langan – President and CEO
It's opened very in line with what we did in the South Houston location, which is the location it's based off of. It's actually a little higher sales, initially, because our launch is much, much better in this market, which is what we anticipated as well. There's a lot of industry around there as well as residential, and so we think that overall, we're very excited. The South Houston location was our number one location for a few years until recently when the Dallas location has passed it up as the number one location. I think that this new location will probably be our number one location. It's going to go through its honeymoon period and then it's going to have a little bit of slowdown. And as we rebuild from the slowdown after the honeymoon period, I think it's going to be one of our top performers for sure.

Q: With that demographic that you mentioned, a little bit different mix residential, does that help your earlier crowd given that there's businesses around it?

Eric Langan – President and CEO
Yes, exactly. It's helping our lunch and happy hour crowds at this time.

Q: Great. Thanks, guys.

Eric Langan – President and CEO
Thank you.

Operator
Our next question comes from Marco Rodriquez from Stonegate Capital. Go ahead, Marco.

Q: Good afternoon, guys. Thanks for taking my questions. I was wondering if I may have missed this on the call or on the slide presentation, but what was the same-store sales number for Bombshells?

Eric Langan – President and CEO
It was almost flat. It wasn't up much but it's held, but we've had such high growth over the last year that it's kind of expected with what we've seen in casual dining with everyone else, sales going down, and a lot of our focus has been on getting the new location open. We're hoping that we'll see a little rebound in this quarter as we've now got this location open and we're getting management's focus back on some of the existing stores.

Q: Got it. Can you maybe talk a little bit about any sort of marketing efforts that you might be doing for either the new Bombshells or the existing Bombshells, anything new or unique that is coming down the pipe here?

Eric Langan – President and CEO
We're talking with some marketing companies now. Now that we have three stores in Houston, we're looking at maybe sponsoring some football radio shows, some different sports stuff to really help build up our sports times, but mainly we're using social media. Social media has been a fantastic way for us to market the concept and get things out relatively inexpensively, and the results have been great for us.

So we're definitely going to stick with our social media stuff, but we are looking at some more conventional media and marketing to start looking and trying and mainly just to build our earlier hours. Our late-night hours are doing very, very well at most of the locations, so we really want to focus a little more on our lunchtime and our early evening hours.

Q: Got it. Can you maybe provide a little bit more color on an update on the franchise opportunity? I heard the prepared remarks as far as taking the opportunity to making sure you're doing it right, but can you give us an update as far as what opportunities you may be looking at as far as the franchisees are concerned and maybe give us some of your thoughts in terms of when you think the franchise opportunity might start to roll into your financials, if you will?

Eric Langan – President and CEO
Sure. I think we're starting to see some restaurant sales rebounding. The fast casual dining has really put a little damper on the sit down dining, and so some of the operators that we're talking to have sit down operations right now and they're a little concerned with some of their existing stuff, so it's a big investment. A typical store investment for them is going to be between $2 million and $3 million with us and so they're cautious.

I do believe that now that we've opened a new store, it's been a couple years since we've opened stores so that was a concern for them. Now we've opened a new store. We have two other stores definitely online right now. One is in construction. They're starting to enclose the building. It will be open in the next quarter. Hopefully, we're getting ready to start the ground clearing and stuff on the other location, which should open by the third quarter of '18. So I think as those locations open, I'm hoping by the end of this year, we're going to see some pretty solid deals and hopefully start signing up some of the people we've been talking to.

The bigger guys are as cautious as we are. They don't want to make a mistake. We don't want to make a mistake. But I do think at some point the numbers and the sales that we're doing, especially in the new locations in our new prototype store, which is a little cheaper for us to build than some of the other remodels and stuff we've done, is going to be appealing to them, and they're going to have a hard time continuing to say no as they look for ideas.

Q: That's helpful. Thank you. In terms of these new Bombshells that you're looking to open, just wanted to make sure I'm confirming here my understanding, the two additional Bombshells that you're looking to open here in the near term that's going to be in the December quarter and then in the June quarter, is that correct?

Eric Langan – President and CEO
Yes, that's the current plan.

Q: Got it. Last quick question if I might, just shifting gears here to the nightclubs, if you could maybe talk a little bit more about the increase you saw in the VIP spend, just what might have driven that in the customer count and any other sort of general trends you're seeing in the nightclub business.

Eric Langan – President and CEO
The only thing I attribute it to is consumer confidence. People seem to be a little more confident, and they're spending more money. That's what we're seeing, especially small business owners. I guess as long as the political climate continues to favor what they think they need to be successful, I think we'll continue to see that spend.

Q: Got it. Thanks a lot. I appreciate your time.

Eric Langan – President and CEO
Thank you.

Operator
Our next question comes from Mike Mork from Mork Capital Management. Go ahead, Mike.

Q: I have a question. With your stock basically doubling and now about 15x earnings, I'm just wondering if in the acquisition front if you would consider stock? And in particular, if some of these potential clubs out there the owners are hesitant to sell because they'd have to pay a capital gains tax, with a stock transaction you could have it so that they get stock and they wouldn't have such big capital gains to pay. I just wondered if that would open up so more—it would still be non-dilutive for you if you bought it at the right, price obviously, it would probably be after earnings per share.

Eric Langan – President and CEO
Right now we still think that our stock, at a 9.4% yield for us, is still relatively inexpensive for us to buyback our own stock. As far as using it for equity in a transaction, it would have to be a very, very unique transaction. We really are actually contemplating right now as we open these new units and we see the cash flow expansion, we could get back to the point where even at $23 our stock is giving us an 11% or 12% return, and we're going to have to start looking at buying back stock again versus growth. So I don't see us issuing any equity at this time for an acquisition or for any type of capital raises. I think we're basically on the border of being a buyer again as we continue to grow.

And even though we expand, we bought up until I think just under $14; I think our last trades were about $13.84 back when we were at $18 million in cash flow. So at $21 million, we don't need much growth at that $21 million to get back to those levels of return on buying back our own stock, so that's what we're going to be looking at.

As far as the capital gains, we've been able to talk with owners, by using debt financing, it's a deferred capital gain, and so they don't pay the tax until we pay on the note payments. So they can defer those taxes out for years and years and years if they want to, so that's all pretty easy. And earn interest at the same time at a rate that they can't get in the marketplace, which is why the owner financing has been very successful for us. We're paying an 8% yield, for example, on the Scarlett's Miami and 9.5% that we paid back in the day on Jaguars.

That's still a much better yield than they can get on treasuries or anything else they can go put their money in and their collateral is the business they've been running for the last 20 years. So, they're very comfortable in their own cash flow of their business being able to pay those interest payments and then for RCI being able to pay the principle if necessary when the time comes.

Q: Okay, that's really helpful. I just want to make sure that the capital gains potential tax wasn't putting off some acquisitions. It doesn't sound like it is.

Eric Langan – President and CEO
What's putting off a couple of the acquisitions, some of the guys we've been talking to right now is of course our federal government and Congress not letting them know what their tax rates are going to be. Everybody thinks we're going to get cut, so they want to see if they're going to get a capital gains tax cut or not. If it's 15% instead of 20%, $5 million on a $20 million deal is a lot of money. That's slowing it down a little bit. So, hopefully we'll get through that by the end of this year and guys will get more solid. I think we're going to have a very nice 2018. We're definitely going to be positioned for everything, in a better position than I think we've been in many, many years. I think in 2006 to 2008 we traded at close to 15x economic value and I think we're not anywhere near that today. And I think we're twice the company we were back then.

One of the main problems with our stock right now today and as far as pricing I think goes is everybody is looking at trailing and nobody has given us any credit still for any of our growth, and I think that's going to change. I think that's when you're going to see the multiple expansion come in to play as we continue to deliver on the growth and we continue to deliver this free cash flow growth of 10% to 15% a year as we get into 2018 and I think definitely as we move into 2019 and we have that 3 year track record going, I think we're going to see significant price increases in the stock and a much lower yield on our free cash flow. We're going to get value for creating that free cash flow.

Q: Okay, that's really helpful. Thank you, Eric.

Operator
And our next question comes from Ishfaque Faruk from Westpark. Ish, go ahead.

Q: Hi, good afternoon, Eric. A few questions. In terms of the 60/40 clubs in New York City, New York City is your third biggest market. What are you thinking in terms of acquisitions in the New York City metro market?

Eric Langan – President and CEO
I don't know of anything for sale in New York City metro market to be honest with you. Obviously, I've said this, I think since 2004. I would like to own every single club in Manhattan, no doubt about that. So, if stuff comes up for sale, we'd be willing to talk to the owners and try to make a deal, but it's got to fit our capital allocation strategy. It definitely fits our management capabilities. So, those are the two things that are very important in our acquisitions right now. I don't want to stress management and we've done two major acquisitions including our new market in St. Louis, so anything we do I want to make sure it fits our capital allocation strategy and it fits well within our management capabilities right now.

Q: So, as some of these 60/40 clubs closed their shops, are you expecting like higher foot traffic in your three locations in New York going forward?

Eric Langan – President and CEO
If locations close, I don't think the customers will just stop participating in our entertainment. So, they have to go somewhere. So, I think we'll get our pro rata share of that business as it spreads among the existing clubs left in the market.

Q: Okay, moving over to Bombshells, some of your Bombshell openings have been pushed back a little in terms of the opening dates. Has it been like due to problems with locations or like you were supposed to open like three in this fiscal year, but you're probably going to be opening two.

Eric Langan – President and CEO
Welcome to trying to build something in the city of Houston. Construction, permitting, it's just a mess right now. We do have expediters. We are working through it. We now got I-10 to the final stages. We probably should turn in the plans for building permits here shortly in construction. Should start early September.

Pearland is well on the way. It's actually under construction. Steel work is done. They're starting to close the building off and they'll start on the interior finishes and whatnot here in the next month or so. So, that one is coming along pretty quickly.

But basically it's just been permitting issues and getting engineers, getting the people to do the work. You hire them and they say they'll have the work done in two weeks and then in two weeks they get the work done, but it's not right, then you have to go back and then it's two more weeks before you get to your next step. Yes, it's been a little bit of an issue for us for sure.

Q: Okay, in terms of Bombshells franchising, how are your initial conversations going in terms of franchising with potential customers?

Eric Langan – President and CEO
The biggest thing that we're facing right now has been the slowdown in casual dining. It definitely has some people on guard, so to speak, especially of anything new. While we believe the concept is great there are only five units open now. This is the first one we've opened in several years. The concept is strong. We're getting great feedback from everybody we're showing the concept to. It's just a matter of the commitment. We're talking about a pretty large commitment from our first franchisee where we want them to commit to a territory of 3 to 5 units or more depending on which market they're going in to and it's several million dollars per unit commitment. So, they have to work out financing. They have to work out some of their things and put all their ducks in a row.

We have guys with money that don't have operators. We have operators that don't have guys with money, so we're getting groups to talk with each other and see if we can maybe put a group together that will work well together, but that takes time as well as they explore what they want and how they want to setup their stuff, but I think we're getting close. Like I said, I think as we open the next unit, as the Northwest Houston unit continues to perform well, it's going to be hard for people that want to open something new to not look at our concept versus the other concepts out there. I think we reach a much larger demographic and have a very solid history now.

Q: Okay, my last question. In terms of share buybacks, you guys updated the slides for your cap allocation strategy. Based on your current stock price it's approximately 9.4%. What level would you be comfortable buying back stock? The last time you bought stock was, I'm going from memory, I think it was $13 and change.

Eric Langan – President and CEO
Right, we were using about 12.7% at that point to give you an idea. So, I think it's going to be a combination of two things would have to have to happen for us to really get back into stock: 1) we continue to see the performance we're seeing in this quarter. Now July was very strong. I'm optimistic about August and September, but at the same time school starts back up and the typical slowdown stuff starts to happen. So, we'll watch and see how that plays out this year.

If we stay strong through August and September and it looks like our $21 million is going to be low and our free cash flow projections have to be raised, we'll look at that yield, we'll put those into our models. I think anything over 10% yield versus doing something new, we have to be seriously thinking about buying back our stock, because we like to get at least three times. If we're going to take a risk, we want to get a three times, at least three times potential return.

The other things is as we have the Bombshells lined up, we do have a couple of properties, but the bank financing, we're going to be generating lots of cash that we don't really have a lot of use for if we don't find acquisitions or we don't have additional properties for Bombshells to buy because we're not going to probably—I don't see us doing more than three new units a year on the Bombshells right now. Though something unique could pop up, but I don't foresee it at this point. So, therefore, we can start having cash pile up on the books that's earning us no yield in the market or in the bank and so we start buying back our stock as we're getting 10% plus yield.

So, really it all depends on what the stock prices do and how our free cash flow model continues to work. We're just going to do the math. Every month we sit down, we do the math. We say if the stock price hits this price this month, we're going to be buying back stock. And that's how we've been doing it and I think that's how we'll continue to do it for the foreseeable future.

Q: Alright, thank you very much, very helpful.

Eric Langan – President and CEO
Thank you.

Operator
And our next question comes from Steve Martin from Slater. Go ahead, Steve.

Q: Alright, thank you. Hi there. We'll see you later, but I have a couple of numerical questions.: If I look at the slide of the Bombshell segment, and I understand its 5 units versus 4, if you did that slide on an apples to apples basis and excluded the preopening costs from this year, and I assume that the unit you closed lost money—

Eric Langan – President and CEO
Yes, it did.

Q: Can you tell me what slide would look like? Basically on an apples to apples.

Eric Langan – President and CEO
It will be very similar to the margins from the previous quarter and from the previous year.

Q: Well, let me ask it this way. What would the sales, instead of $5 million, what would the sales be?

Eric Langan – President and CEO
What were their sales down there? You, know I don't know. I'd have to go pull the numbers. That was a year ago.

Q: Okay.

Eric Langan – President and CEO
Unless Last year was probably, I think they were doing about 35 a week, 35 x 13, about 500 and some thousand a quarter.

Q: And lost money?

Eric Langan – President and CEO
And lost money, yes. $455,000 actually is what I came up with. Around $450,000 in sales.

Q: Okay, and can you tell me what those preopening costs were that got expensed this quarter?

Eric Langan – President and CEO
I don't know off the top of my head, but it was several hundred thousand dollars. We had training. We actually brought people in and did a—we made training manuals and some other things for the restaurants for the wait-staff. And we hired a full-time trainer that's now traveling from store to store training all of our wait-staff and bar staff and whatnot. It's our concept and what it's about and how we expect service. So, there's definitely some additional coverage. Plus, we had all the training for the kitchen staff, bar staff that type of stuff. So, we're really upped our payroll a lot at some of our other locations to train the staff that's now moved to the new location.

Q: Right, and because you opened the new location a couple of weeks late, you absorbed those expenses for longer period of time?

Eric Langan – President and CEO
Exactly, for about 45 days instead of 30.

Q: Okay, can you comment on the oil field markets down in Texas. Were they better? Have they continued to improve?

Eric Langan – President and CEO
Definitely, it is improving dramatically for us. Both of our locations there, revenues are up and profits are up. They've learned how to make money at $50 oil. At $60 oil I hear that it will be like the good days from some of my friends up there. So, we're watching oil and see what it does, but it looks like it's pretty steadily holding at $50 right now, which is profitable for them and has been good for us.

Q: Okay.

Eric Langan – President and CEO
I mean it's not the crazy days of $100 oil, but it's solid. I don't think—I guess that we're seeing increases again, nice returns. I want to say that the one club was up about 30% and I think the other one was up about 18%.

Q: Gotcha.

Eric Langan – President and CEO
Year-over-year. So, it's made a big difference from what oil prices were last year for certain.

Q: So, when we look at fourth quarter, you're going to have the full quarter of Scarlett Miami. You're going to have full quarters for St. Louis, or almost full quarters for St. Louis correct?

Eric Langan – President and CEO
Well, for one club at St. Louis, yes; for the other one, no.

Q: Okay.

Eric Langan – President and CEO
We'll have month and a half or whatever.

Q: Month and a half and then you're going to have almost a full quarter of Bombshells.

Eric Langan – President and CEO
Right, we'll have 11 weeks of Bombshells.

Q: And then when you get into first quarter '18, you're going to have full of St. Louis, full of Bombshells.

Eric Langan – President and CEO
Full of everything now expect for the new Bombshells that should open in that quarter. Everything else will be full quarter.

Q: And then we'll get a partial of Bombshell 6.

Eric Langan – President and CEO
Correct.

Q: That's great. Okay, you still have some real estate available for sale?

Eric Langan – President and CEO
Yes.

Q: How many pieces is that and what do you think their estimated—what your estimated market value is?

Eric Langan – President and CEO
Based on the Q, we have a little over $10 million worth still listed for sale with the new Dallas location that we've added to that. With that Dallas location, I think our book value on that is about $5.2 million after the write down for the operation. The appraisal is higher than that and then it still has an adult use and a liquor license that we're putting back on the property that should be reissued here in the next few weeks.

Our asking price right now is $6.8 million for that property with all licenses and everything if we can sell it as a club. If we sell this just real estate, we'll probably get about a million less than that would be my guess for that Dallas property. Everything else, we have two properties in Houston, a property in Austin. I have a contact and email on the property in Austin, I got yesterday that I'm going to review when I get back and we'll see. It's a little lower than the price I wanted, but it is an all-cash offer, so we'll see how that works out. We're also expecting one on one of the Houston property here in the next week or so. And then of course we have a development property where we're the building the Bombshells in Pearland right now and where we will be building in the Bombshells on I-10 in Houston. And once we have those Bombshells built, I think that property will move pretty quickly once we have the traffic and all the infrastructure put in.

Q: Okay.

Eric Langan – President and CEO
Those are build ready lots at that point.

Q: Okay, and I don't know if maybe I missed this, I know the Miami market has been good. You have a couple of clubs that have closed. Can you talk about the club, the new club you bought and I know you were going to make some management changes and there were some problems with the previous management. Can you tell us about that?

Eric Langan – President and CEO
Well, it wasn't really management. The management is still there. We have the same general management team for about 15 years. A lot was just the owners. There were multiple owners and I think there were some just internal conflicts and disagreements between all the owners. So, there were too many leaders, too many chiefs and not enough Indians type deal.

Ed has taken that club over himself down there, so he lives in Miami. He's been there almost religiously day and night doing some remodeling. They let the carpet go. They let the chairs go. The lights and sound are probably the only things that are really up cap a 100% and we painted the building. We fixed all the lights that were broke on the signs and really cleaned up the outside and we're seeing increases in sales. Every week seems or every month it seems to be getting a little stronger for us. And we have their comps, so we know we're up year-over-year from what they were doing last year. We're just very excited. I think we're going to see some very nice growth.

Q: How are margins at that club versus what you expected?

Eric Langan – President and CEO
They are right in line. I mean everything—if anything, they are going to be better because we're increasing the sales. We haven't increased costs. In fact, we cut some of their costs, the back of the house costs we've been able to lower.

Q: Okay, and did you tell me once that there were some more clubs in that market that are going to close next year?

Eric Langan – President and CEO
There are rumors that other clubs might close. They're not—it's not for legal reasons. The two clubs that closed, closed because they were sunsetted. So, there are rumors that another club in that market might close at some point, but there's nothing solid on that at this point.

Q: Okay, thanks a lot. We'll see you later.

Eric Langan – President and CEO
Yes.

Operator
[Operator instructions]. And our next question comes from Bill Brown. Bill, go ahead.

Q: You had terrific quarter. Questions on the buildup of the free cash flows you talked about. You mentioned you're focusing a lot about the buying back stock. What's your thinking long-term in terms of where you see the dividend heading?

Eric Langan – President and CEO
The dividend is not really tax efficient. I guess it depends on what the tax code changes that we' keep getting promised, what happens with that. That could change our thinking on that.

Right now I don't see us raising the dividend. We're going to continue to pay it because we started it and it keeps us so that no matter what the stock does, we'll either have a 1% yield or $100 million margin cap. So, we shouldn't have any problem with funds owning us, that type of stuff. But at this point I don't see us really raising it in the near future anyway. Unless, of course, we just continue to build our cash flow and it gets so much it's like, we pay out less than million dollars a year, so it's not too bad for us, but at some point we talk, but we just don't see any real reason to raise it at this point.

Q: Okay, thank you.

Operator
[Operator instructions].

Gary Fishman – Investor Relations
Okay, one last time, does anybody have any additional questions? Okay, operator, let me wrap up.

Thank you, Eric and thank you, everybody for asking your questions tonight. To wrap up let's turn to Slide 7 for our calendar. First item as I mentioned earlier, you can meet management of Rick's Cabaret in New York tonight from 6 to 8. The next event after that is the company's Annual Gentlemen's Club EXPO in Las Vegas that runs from August 27th through the August 30th. On September 19th is the company's Annual Meeting at its corporate headquarters in Houston. October 10th, we're scheduled to announce fourth quarter club and restaurant sales. And we're currently planning to be at the LD Micro Investor Conference in Los Angeles in early December and then following that we'll announce fourth quarter and yearend financial results.

On behalf of Eric, the company and our subsidies, thank you and good night. We'd also like to say a special thanks to the new funds that have joined us as a result of our now being included in the Russell Indexes. And as always, please visit one of our clubs or restaurants. Thank you very much.