Transcript of RCI Hospitality Holdings, Inc.
Second Quarter 2018 Earnings Call and Webcast
May 10, 2018

Participants
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Eric Langan - President and CEO

Analysts
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Marco Rodriguez - Stonegate Capital Partners
Ishfaque Faruk – WestPark Capital
Darren McCammon – ProActive Financial
Evan Tindell – Bireme Capital
Steve Martin – Slater Capital

Presentation

Operator
Greetings, ladies and gentlemen, and welcome to RCI Hospitality Holdings Fiscal 2018 Second Quarter Conference Call and Webcast. [Operator Instructions]. As a reminder, this conference is being recorded. It is now my pleasure to introduce Gary Fishman, who handles Investor Relations for RCI. Please go ahead.

Gary Fishman - IR
Thank you. We've changed our Corporate and Investor Relations Website a little bit to make it easier to find things. If you are looking for today's conference call presentation and don't have it, you can click the Company and Investor Information button just under the RCI logo. That will take you to the company and investor information page. Scroll down a little and you'll find all the necessary links for the second quarter.

If you'd please turn to slide 2, I want to remind everybody of our safe harbor statement. It's posted at the beginning of our conference call presentation, 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 on this call as a result of developments that occur afterwards.

Please turn to slide 3. I also direct you to the explanation on non-GAAP measurements that we use and are included in our presentation and news release. Finally, I'd like to invite everyone listening in the New York City area to join us tonight at 6:00 to meet management at Rick's Cabaret in New York, Manhattan's #1 gentleman's club. You can also tour its sister club, Hoops Cabaret and Sports Bar, next door. Rick's is located at 50 West 33rd Street between Fifth Avenue and Broadway, around the corner from the Empire State Building. If you haven't RSVP-ed, ask for me at the door.

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

Eric Langan - President and CEO
Thank you, Gary. Good afternoon everyone.

Please turn to Slide 4. After the market closed, we issued our Second Quarter Earnings News Release and filed our 10-Q. We reported another great quarter of strong core results. The new Bombshells in Pearland, a Houston suburb, is doing very well. We now have four new locations in various stages of development that will expand the chain to 10 units by the middle of next year. We also announced we have reactivated discussions to acquire a number of night clubs from several owners.

Turning to our results, GAAP EPS for the second quarter was $0.48 a share, up 23% from a year ago. During the quarter, we wrote down the note from the sale of Robust and settled two lawsuits. Excluding those and other small items, non-GAAP EPS came in at $0.65, up 59% from a year ago, and free cash flow increased 9% year-over-year to more than $5 million.

Our outlook continues to be favorable for the second half of the fiscal year, and we are reiterating our fiscal 2018 cash flow target of $23 million.

Please turn to slide 5 for an analysis of our second quarter operating performance. Total revenue increased more than 19% year-over-year to more than $41 million. 16% of the increase came from new units and 5% from same-store sales. All core revenue lines continued to grow. Beverage was up 22%. Higher margin service revenues were up 14%, and food was up 25%.

GAAP operating profit increased 10% to more than $8 million. On a non-GAAP basis, you can see the real strength of our business. The nightclub segment maintained a high 35% margin. Margin for the Bombshells segment expanded approximately 200 basis points to more than 20% for the first time.

Corporate overhead costs fell 17% to about $3 million as a percentage of total revenues. They declined to 7.2% from 11.8% in the preceding first quarter and from 10.3% in the year ago second quarter. All told, non-GAAP operating income increased 38% as margin expanded to 25.7% of total revenue compared to 22.2% in the year ago quarter.

Please turn to slide 6. A variety of factors drove these revenue and margin gains. In general, there has been an improvement in our Nightclub and Restaurant portfolio. Along with increased operating leverage from higher revenues, we have also seen increased customer counts in both nightclubs and restaurants.

As we have previously reported, the quarter also benefited from the strong marketing around the Pro Football Championship in February and Pro and College Basketball games in March. There were some significant factors that provided a tailwind to our major segments. Nightclubs saw higher spend per customer. Bombshells benefited from continued success of the Houston Rockets and an updated menu featuring new items.

Corporate costs were down sharply. On a sequential quarter basis, this reflected in part completion of our extensive fiscal 2017 audit and the transition to our new financial IT system. The second quarter is likely to be a low quarter for these costs. In general, we anticipate overall expenses in absolute dollars will rise going forward. That would be due to the opening of Bombshells in Pearland and on I-10 East and the hiring of vendors to help us develop controls governing our new financial accounting system, and to write reports automating business and financial analysis.

There were two other factors that contributed to our second quarter performance. Cost of occupancy, which we calculate as a combination of rent and interest as a percentage of revenues, continued to decline. And because of the new federal tax law, our effective tax rate was approximately 30% lower than a year ago.

Please turn to slide 7. Same-store and total club and restaurant sales are up now for 8 quarters in a row. This is the longest continuous quarterly uptrend we've had since early fiscal 2013. In the third quarter, we start comparing against year ago increases of 6% plus in same-store sales, and increases in total revenue from the acquisitions of Scarlett's Miami and the club we renamed Scarlett's in St. Louis. And in the first quarter, we begin comparing against Bombshells 290.

This is where our new Bombshells Pearland and our Bombshells rollout plan will help to enhance future sales gain, while we pursue the acquisition of new clubs. As for non-GAAP operating margin, we are pleased to see year-over-year growth. The quarter's margin was the highest it has been in the last 2 years. Based on my comments on the previous slide, operating margin is likely to moderate somewhat in the second half.

Please see slide 8. Cash generation continued to do well. Adjusted EBITDA was up 35% year-over-year to more than $12 million. This too, is the highest quarterly level in the last two years. As for the six months, adjusted EBITDA was up 37% at close to $24 million. As for cash itself, we had $12.5 million on March 31st. Even with all of our expansion activity, cash increased nearly 5% from December 31 and has grown 26% from the start of the fiscal year. As for free cash flow, we are now up 28% for the first 6 months to just under $13 million. That gives us even greater confidence of hitting our target for the year.

Please turn to slide 9. Debt continues to be very manageable. It is up approximately $1 million from December 31st. Weighted average interest rate is down 7 basis points with declines in all categories. Our real estate debt now includes $10 million related to Bombshells properties. As we've discussed in previous calls, when possible, we are using bank financing to purchase Bombshells real estate and finance construction, fixtures, and furniture to enhance our cash-on-cash returns.

Please turn to slide 10. Regarding debt maturities, in the second quarter we refinanced the Bombshells $1.9 million realty balloon into a construction loan and began construction on Bombshells I-10 East. In May, we refinanced $3 million in the Scarlett's Miami seller-financed non-realty balloon. It now balloons in May of 2019.

The only major balloon in the next five years is the $5.4 million related to the Scarlett's acquisition. We believe we can extend that if needed or we can refinance it before the balloon is due. Even though total debt has increased slightly, with our higher revenues and declining interest rate, cost of occupancy has continued to fall. In the second quarter, it was 7.4% of total revenues, down from 7.7% in the first quarter and down from 8.3% for all of last fiscal year.

Please turn to slide 11. On April 11th, we opened our sixth and largest Bombshells in the fast growing Houston suburb of Pearland. For the first three weeks, sales have averaged more than $160,000 per week, making it our most successful Bombshells launch to date. We now have four locations in various stages of development in greater Houston. I-10 East Houston under construction and scheduled to open in September of this year. U.S. 59 in Southwest Houston is under construction. That unit is scheduled to open in December. We recently closed on a property on U.S. 249 in Tomball, north of Houston, and that unit should be open in March of 2019. And we are finalizing site selection for a location in Katy, Texas, a fast growing West Houston suburb. That location should be open by the end of June 2019.

Over the last year, we have assembled a strong group of architects, contractors, and vendors for the creation of 290 in Pearland. Based on this experience, we're hopeful, barring any unforeseen delays, of being able to deliver new Bombshells on a regular schedule. The new units will bring the chain up to 10 Bombshells by the middle of next year, and, based on recent results, the average Bombshells is now running at $4.5 million annually in revenues with an operating margin of 20%.

Doing the simple math, we are looking at having a Bombshells business by the end of next fiscal year with an annualized run rate of $40 million to $50 million, in addition to operating leverage to continue to expand segment operating margin. Our next target markets for Bombshells are in San Antonio and Miami.

Please turn to slide 12. We continue to apply the lessons learned from the past and apply the formula we have developed to almost all of our decision making involving capital investment. We look at our free cash flow relative to our market cap. With an estimated free cash flow of $23 million this fiscal year and a current market cap of more than $280 million, we currently have an after-tax yield in the low 8% range on our equity.

That is what we consider to be our risk free return for buying back our own assets in the open market. At that yield, we are more likely to use capital for club acquisitions, or to open Bombshells as we are doing. To compensate for the added risk, our hurdle rate has to be at least 25% to 33% cash-on-cash return unless there is a significant strategic rationale to do otherwise. If an existing club or restaurant is not generating a significant return, we are more likely to dispose of it, free up the capital, and use that money for more productive purposes.

Should free cash flow rise or our stock price ease to the point where that yield is in double-digit percentage range, we would look at buying back shares again. For the longest time, we have been saying the stock would have to be trading at a significantly higher price for us to consider accelerated pay down of our most expensive 12% debt assuming no onerous penalties. The new tax law changes that dynamic. With the estimated tax rate of 23%, the after-tax yield of paying down 12% debt is more than 9%, and that's far more attractive.

To wrap up, please turn to Slide 13 for a review of our three- to five-year financial goals. Our objective is to grow free cash flow by more than 50% from our fiscal 2017 level to approximately $30 million a year. On a per share basis, we'd like to grow that on an average of 10% to 15% a year. We have three strategies to achieve that.

One, acquire more great clubs in right markets. On average, we have made more than one club acquisition per year, and last year, we acquired 2. Two, continue to expand the number of company owned Bombshells. Our target is 3 per year. And three is strict adherence to our capital allocation strategy. While we are in growth mode, we will not be pressured into deals that we don't like for the sake of growth. Our aim is to make sure that each new acquisition or restaurant is right for us. If we can't find the right acquisition or Bombshells location, we will sit and wait and let our capital build. And if our stock price doesn't adequately reflect our cash generating power, we'd be happy buying back shares.

Now, let's open the call for questions.

Operator
[Operator instructions]. Our first question comes from the line of Frank Camma with Sidoti.

Q: Eric, obviously good quarter. I wonder, consumer confidence, small business confidence, stock market, everything is positive here and not to be sort of playing the other side I guess, if you will, but I guess how strong—I'm not asking you to be an economist, but at what point does it become harder and harder to comp? It seems like to me how good can it get. It's really directed towards two different sides here. I mean I think it affects your restaurant business differently than, and you can tell me if I'm wrong, than your adult side. Meaning I think your restaurants can have a long runway but maybe not so on the adult side. So maybe you can address that first.

Eric Langan - President and CEO
We haven't seen an end to it yet. April was decent for us. The first week of May has been good. Right now, I think that we're going against very strong comps. I don' think we'll be in the positive territory as high as we maybe were this quarter and the last quarter because we did have 6% growth for this last year. But I'm very optimistic at

this point in the quarter. Obviously, we're only five weeks in but like I said, very optimistic that this is still going to be a positive quarter year-over-year, which would give us 9 in a row.

Q: Let's talk about pricing then. Obviously, there's really no pricing per se in the adult side. But do you get any pricing on the restaurant side given that commodities, we're seeing some compression?

Eric Langan - President and CEO
With the new menus, we did raise certain menu item prices to bring our costs back in line. You'll see that a little bit in the food cost, in our cost of goods sold. I think you'll see it a little bit better this quarter because we did it in mid-February. So it's only about half the quarter, but it's minor. But basically, for March, it brought our food cost back down from 34% to about 30% for the restaurants, which is very good for us.

And we also were able to go in—we reviewed in this last quarter a lot of our clubs and made some small changes to some pricing. We finally passed on some of the liquor cost increases and some of the beer cost increases to the consumers by raising drink prices a quarter here and a quarter there. Nothing significant, but just enough to get our costs—we want to keep our costs within certain margins and they were getting a little above those. So I think that will help especially in this next quarter of keeping those costs down.

I think we will see salary and wage costs increase in the next quarter a little bit, especially with the new stores opening. And I think that some of our other G&A will go up a little bit due to the hiring of the new internal audit firm that's going to help us write everything and set everything up so that we have all of our financial controls proper with our new ERP system, and hopefully get a much better, clean bill of health from BDO this year in our audit.

So we're working towards those things. The new ERP system has definitely helped our overtime, especially in this last quarter, it was very, very low, which is good. That helps lower cost tremendously and of course, we didn't have as much of the cost of the audits and those types of things in that quarter.

So like I said, I'm optimistic. I do think, like I said, those costs will raise a little bit in real dollars and we'll just have to see where, as far as percentage wise, where the revenues come in at, whether we continue the same-store sales growth and keep pushing the numbers up.

Q: I think I remember when I was down visiting one of your restaurants that you mentioned that you were one of the largest purchasers of Budweiser, I could have that wrong, or beer. Are you getting any benefit now that you're opening up more and more restaurants, like on a volume discount? Or can you explain how that works for general alcohol?

Eric Langan - President and CEO
We were for a while. Anheuser-Busch has had some management changes and some of the things are changing there. So it hasn't been as lucrative as we would have liked, but we are working with their people and we're working with some other beer suppliers as well. So next quarter, I'll have a better idea of where we're going to be with that. Our national beverage director is working on a few issues to try to bring our costs down even more.

Q: Last question from me and then I'll hop off is just seen a lot of restaurants talking about how they, I know you talk about the ERP system, but how they engage and use technology for the customer. And what I mean by that is, and I don't know if you already do this, but as far as apps that people can order ahead for takeout. Can you talk about that and do you have much of a takeout business already at Bombshells?

Eric Langan - President and CEO
Bombshells isn't really a takeout place. It's a come, stay, eat, and play type place. So I mean, while we probably have some take out, it's not something we market or push, for sure. Our food is better hot, so it's not like pizza where it travels well. So like I said, it's not something we push. We are in the process, as we've expanded Bombshells, of looking for maybe a social media director, maybe looking for a brand director or something along those lines. We're kind of negotiating those things now amongst ourselves and talking amongst ourselves to really kind of solidify the brand so we can take it to the next level.

Especially as we move—right now with most of the stores in Texas and really, the majority of the stores in Houston and everybody is really close together, it's kind of easy to keep everything the same. And so we are worried about that as we move towards the Miami market, making sure that we have all of those things set up right and basically, the formula mastered.

Q: You all have the value of the brand when you move to Miami initially, or the brand awareness as you open each incremental one in Houston.

Eric Langan - President and CEO
Right. Houston has been great. Opening Pearland, everybody already knew who we were. Everybody was excited we were coming. Of course, the hurricane put us four months behind so we had an extra four months to push and market. They see the building sitting there for an extra four months, which probably didn't hurt people wanting to know what was inside.

But now, hopefully, these new stores are going to open on time. But yes, in Houston, we definitely have a strong brand recognition in that market now. So as we move to Miami, we want to make sure that since we're going to be recreating it there that we create it in the exact image of what we've done in Houston.

Operator
Our next question comes from the line of Marco Rodriguez with Stonegate Capital Partners. Please proceed with your question.

Q: I'm wondering if you can talk a little bit more about the Bombshells expansion plans here. Just first off, the table in your presentation with the different target opening dates. Should we be thinking of those particular dates being the revenue generation start time or is that maybe they open at the end of that quarter and then revenue starts the prior quarter?

Eric Langan - President and CEO
We're thinking the last two weeks of the quarter, based on the way our flow is working right now. Unless construction speeds up a couple weeks or they gain a few weeks here or there. And unfortunately, with construction, it's always give or take a month with these guys. But I think we've got it down to give or take two weeks now. So either we could open two weeks earlier if we open it up the first of, say the next one is going to open in June, it could open the 1st of June or it could open the 30th of June—I mean August, September, I'm sorry, September. So the 30th of September, we're targeting around mid-September. Maybe we get lucky.

I'm hoping. We are getting to the point now where, because we have four stores lined up with our suppliers, they now know they're going to have a year's worth of business from us. So we are getting some priority treatment on long lead items, which will help if something comes up and we can get open two weeks earlier because everything else is done, we won't be waiting for any type of equipment or decor or anything. All of that, we secured pretty well now.

So basically, it's just how quick they can get the construction done and get the inspections, and how much it rains, those types of things that they can't pour parking for two weeks because it's muddy, they can't do this or that. So that's really kind of where we're at. So basically, I would plan on the real revenue starting the quarter after. So we say we're going to open in September, so the real revenue would start in the October first quarter. You'll get a little bit but it won't be significant in that first quarter, in the quarter of opening.

Q: Understood. Appreciate that. And then in terms of the new Bombshells, the Pearland location, I believe in your press release you guys mentioned that this was one of the most successful launches that you've had here. Was there anything special you did in terms of perhaps marketing or was this maybe what you were alluding to earlier before on one of the questions as far as pent up demand given the shift that you saw and the opening from the hurricanes?

Eric Langan - President and CEO
I think some of it was pent up demand. The marketing we do is what I call guerilla marketing. What we do is when we do all the training, after all the training session, when the new wait staff is first being trained, then we take them on promotion runs where we'll run out to all the car dealerships and pass out stuff. So it's really more—we don't really do television, radio, that type of marketing stuff—it's really more guerilla. We use the wait staff to go out and market, and promote the business.

And there was definitely pent up demand in Pearland. We bought six acres there and we built it with 196 parking spots. And we use 196 parking spots and a whole additional four acres of developable land where people were parking in grass. It is a very, very busy location for us.

Q: And then can you talk a little bit about the new target markets you're looking for, for Bombshells, San Antonio and Miami? Are you going to target one area before the other and maybe if you could just talk a little bit as far as why those particular 2 markets?

Eric Langan - President and CEO
The demographics are perfect in San Antonio. We like Miami. It's got decent demographics. Definitely a lot of money and a lot of great restaurant row type areas in Miami. The weather will be great for our patios and we definitely want to make this concept work in another market to help with franchising down the road. I think as we move into other markets and build the brand awareness that it will make our franchising easier. And we know Miami and we have a couple clubs there. We have staff and people there, as far as office type staff that will help with accounting. So we just think it's an easier market for us to grow in than trying to go to, say, Phoenix-Scottsdale right now, which is another market we're considering heavily.

Q: And is there a sort of target date when you anticipate starting to move into those markets?

Eric Langan - President and CEO
I'm hoping that the location after our Katy location would be our next location, which would put us in the basically looking more at the September-December quarter of 2019 for the actual opening. We're actually looking now so depending on how quickly we can secure the real estate and get the plans developed, and get through there. We have to learn the building permit processes in those markets, get the right contractors and that type of stuff in those markets.

So while we do have a lot of experience with the clubs, this is new build construction. It will be a little different for us. So it will be a little learning process for us. Basically, it takes us about from the time I find a location and put it under an L&I, it takes us about 12 months to get open. So if we can find something, say, by the end of June because we're basically looking in that market now in Miami, and get it under contract by June, we could push for a June-September opening basically.

Q: And last quick question and I'll jump back in the queue, just kind of shifting gears here to the nightclubs. I believe in your prepared remarks, you mentioned acquisitions. You're in the midst of talking to, I guess, quite a few potentials out there. Can you kind of give us a sense as far as that backlog, if you will? Do you have any very large type acquisitions or are these more kind of tuck-in? Any kind of color there?

Eric Langan - President and CEO
A little bit of both. We're talking to a lot of single-club operators and we're talking to a couple of multi-club operators. We're talking with several operators, some in markets we're in, some in new markets. We're doing some due diligence on a few right now as far as going through financial data. We're under nondisclosure so I can't really discuss where or who or anything like that at this point. That's about where we're at in the process. Some of them would take—the licensing could take a month to two months to complete, and in some that licensing, transfer would be almost instantaneous, so once we make the decision, it would just go straight through.

Operator
Thank you. Our next question comes from the line of Ishfaque Faruk with WestPark Capital. Please proceed with your question.

Q: A couple of questions from me. In terms of your margins, this was one of your highest quarter gross margin earnings reports in a long time. Was that primarily a function of the Bombshells price increases or what?

Eric Langan - President and CEO
No, I think Bombshells helped a little because they've been 14% or so and they are 16% to 20% now, so that's definitely helping. But I think what really helped, we closed two locations that were underperforming locations. We put that real estate up for sale. We've actually sold some underperforming real estate which is helping lower costs. We had a lot of increase in costs in the last quarter because of the audit and because of the switch to the ERP system, especially with, I believe, about 1,000 hours of overtime in that quarter for our corporate office staff and then this quarter it's not there. So, I think we would have seen it a little better in the last quarter had we not had those unusual expenses and then it's really going to depend on where the revenue numbers stay.

If these revenue numbers keep staying and we keep the same store sales growth, the nice thing about our business is the fixed costs are set and so every time we add a dollar in revenue, we can roll 70% of that to the bottom line once we're above a certain point. So, as you're seeing all these extra dollars come in right now from the same sort of sales growth, a lot of that travels to the bottom line. We're just going to have to watch and see how the comps go year-over-year in this quarter and the next quarter and we'll have a really good idea of where we're headed.

Q: Yes, and in terms of going forward, should we assume a similar trajectory of your gross income structure for Bombshells and the other units or was this quarter primarily an anomaly?

Eric Langan - President and CEO
I think we're going to continue to see about $4.5 million per store. Pearland will probably be high this quarter. We opened at $160,000. I think that store will probably level out in terms—it's a big honeymoon period, there's a lot going on, you have the Rockets in the playoffs, the Astros were playing the Yankees, so we had some pretty big draws for the opening—for those opening three weeks. I think we'll see that, as long as the Rockets stay in the playoffs, we're going to see some pretty big numbers through May and June and then we'll probably see it settle down and average around. I think about $120,000 a week is what we're going to be looking at that store based on the opening numbers.

Q: Okay, in terms of the clubs, how are your conversations generally going, especially in this strong macro-economic environment? Are the club owners asking for too high a price?

Eric Langan - President and CEO
They are pushing the envelope, for sure, which makes the process slower. Plus, I always like to say, sell in May and go away, well in our business, after May, it goes way, way down and by August, September, you're going, what am I doing in this business? Look at most of our acquisitions. Most of our acquisitions, we actually sign all the deals in that July, August, September type are and we close between October and February depending on licensing and due diligence and whatnot, so I think that we're going to follow that trend again this year. The difference between this year and most years, we've already been talking to everyone through the top times where normally we don't start getting the phone calls until July, August, that's when we start getting the phone calls and we start going all the talking. We were actually talking earlier, so I think we're ahead on some of that and I think basically, we've made offers to several owners and they're contemplating and I'm sure they're out shopping to see if they can get somebody else to pay them more and I think as they start realizing that we're the real cash buyer, we're the ones with the cash, we're the ones that have the history and they're not really going to get offered more money or be paid faster than we're going to take care of them with the leverage buyout and the security that we give them. I think they're going to come round and we'll start seeing some acquisition closes.

Q: Okay, so a year in advance negotiations with several parties.

Eric Langan - President and CEO
Yes, and basically whoever goes first, we're going to react the fastest on and the rest of them will have to wait for us to be ready for them. That's the way I look at it.

Q: Okay. In terms of financing these deals, is it going to be the same structure, some cash, some debt, some seller financing, or are you contemplating different financial structure?

Eric Langan - President and CEO
No, I think we're going to continue with what's been working for us. We have cash on hand and I think we're—I'd have to look but we ended the quarter with $12.5 million and I think we're back up over $14 million and change. We have a couple of real estate transactions that are going to close here in this next quarter that we put under contract that I think we're in the ending feasibility studies and so closings will be 30 to 60 days from now on a couple of those, so we'll end up with a little more cash. We're sitting on plenty of cash to do acquisitions. We have $6 million in cash on hand that we can afford to put into and acquisition right now and we can easily go borrow money and the owners will carry paper.

Operator
Thank you. Our next question comes from the line of Darren McCammon with ProActive Financial. Please proceed with your question.

Q: Congratulations on another blowout quarter, guys.

Eric Langan - President and CEO
Thanks, Darren. The team has been, especially the operations team, has been doing fantastic and like I said, the new ERP system has really helped start lowering some of the corporate overhead and costs like we thought it would, so everything's getting simpler. That's the plan.

Q: Good to hear. So, I understand you're pretty far along on a number of club deals. Do you actually have any term sheets yet?

Eric Langan - President and CEO
Not that I can discuss. We're under strict nondisclosures, so I mean, yes.

Q: Okay, well, let me put this another way. You have a number of deals going well along. We know that. And none of those are in your current free cash flow forecast.

Eric Langan - President and CEO
Correct.

Q: You tell us about three Bombshells a year and yet you're actually opening four.

Eric Langan - President and CEO
Well, it will be three in each year though, because the ones that open in this year will add to the Pearland that just opened. The last one we opened was in July of '17. We'll open three in '18 and then as we push in, I plan to open three in '19. If we get lucky, I said, and we find a Miami location early, then we could end up with a fourth one in '19, but we'll still only have three actual openings in '18. They'll just be earlier in the year. These open later in the year of '18 and we're opening three earlier in the year of '19. But it's like a said, we could give us time to do a fourth in '19 if we decide to.

Q: Okay, because I look at that chart and I see one per quarter.

Eric Langan - President and CEO
Right now, for the next four quarters, but you have to remember that's three this year, three next year. And we may get to the point where we just do one a quarter. I'm not saying that's not where we're headed but that's not where were at yet.

Q: I understand. Also Pearland at $160,000 a week, I mean, let's say it goes down to $120,000, that's still $6.2 million a year, that's still way above your average.

Eric Langan - President and CEO
Absolutely. Pearland has been a homerun for us. We planned for it but it's just nice to see it working.

Q: So, my question is, at what point do you raise this target? The $23 million free cash flow target.

Eric Langan - President and CEO
Yes, I mean, we're close. We're thinking about it. I mean, as we get through May, June, that's something we might look at. I want to make sure—there are some little things out there that could take some cash from us. I just want to kind of make sure everything flows. I do have a little bit of margin of error built in right now, for sure, especially with as strong as this quarter and the last quarter were in free cash flow. It's possible that we'll do more. I don't think we'll do less than $23 million, let's put it that way. I'm very confident that at this point that $23 million will be the low end of where we come in at, not the high end.

Q: Are you waiting for a club purchase before changing things like that?

Eric Langan - President and CEO
That's it, yes. I mean, a club purchase would definitely affect it. There has to be a significant club purchase and we have a couple of small deals we're working on that are strategic for us that fall in to this capital allocation strategy and are easy for us to operate. So, we are looking at a couple small units that are in similar markets or close markets to where we are now that gives our regional management expansion. Like I said, we are looking at a couple of really, really nice single stores that are very strong markets for us and then a couple of multi-club operators that would be obviously fantastic to pick up over the long haul.

I will say the bigger load acquisitions are the hardest ones to really put together. There's just so many moving parts and regulations we have to deal with and due diligence that we just have to do to make sure that there's not some reason other than hey, the guy wants to get out of the business. He's getting older. He's tired of the 3 am phone calls. That there's not something behind it that we're not seeing. We're very thorough in that regard.

Q: Do you have an appetite for a really big acquisition, like taking a big bite at Déjà Vu or something like that or is that just too big?

Eric Langan - President and CEO
It depends on structure. I don't think anything's too big if it's structured right, especially if it's a lot of LBO. A lot of owner taking paper. I'm paying them out of their own cash flow. That makes it easier for sure. As far as the company goes, we have the ability to raise money. It depends on how much real estate is involved and how much money—if we can pull the money from the bank on the real estate and whether they take seconds. There's just, like I said, a lot of moving parts. They're doable. I think $100 million deal is doable today if it's structured properly.

Q: Switching gears a little bit, you guys grew EBITDA about 35% this quarter. You're trading at about 10 times EBITDA or 10x EV to EBITDA. That's quite a disparity. Do you have any reason for that that you can think of?

Eric Langan - President and CEO
It's expanding slowly. We were trading at 8 times for a while. We were trading at 6 times for a while. We were trading at 2 times for a while. I think it's just awareness. We have to continue to perform. We have to continue to show the market that we're going to do the things we're doing and eventually, we'll get multiple expansion. It's a slow process. I know that you investor guys want it to go really, really fast, but the reality of it is I think we have to keep performing. We have a long history. To think that we're going to change the whole market in this two to three-year period that we've adjusted with our capital allocation strategy, I mean, we really have. Our stock's not $2 or $8. It is trading at a $30 range. We're trading at 10 times and not 2 times or 3 times.

So, we're getting there. I, personally, would like to see it at 15 to 17 times like some of these other companies are out there, especially with growth levels that we have. It would sure make things easier if we could raise cash with our equity and our cost of capital was 2% or 3% versus 10% or 12%, but it is what it is right now and we're just going to keep working it. Keep doing what we're doing.

Q: Like El Dorado is the one I always used to comp you against. They're like a 15. You're at 10, but they're a sin stock. They're real estate heavy. They're rolling up in industry. They have significant entertainment food and alcohol. I guess, what's our problem?

Eric Langan - President and CEO
Like I said, I think the story is still a little new. I mean, it's a couple years and like I said, we had a long history where all the decisions that we made weren't always the best capital allocation decisions. It took us time to get through that and we're going to have to keep working and keep doing what we're doing and keep showing the market that A) we can grow, and that B) we're not going to make those mistakes anymore.

Q: Okay, fair enough. Keep pounding that free cash flow slide is what I would say.

Eric Langan - President and CEO
Absolutely.

Q: Along those lines, you said getting the word out. How do you plan to get the word out?

Eric Langan - President and CEO
You'll see on the back of the presentation it shows our calendar. We're doing some events. We're doing some non-deal roadshows. We're going to meet with some people here and there around the country. We're starting to talk to some bigger funds, and I think that's just the way we do it. We just slow and steady.

Q: Okay. I can step off the call if there's another caller and come back. Should I do that?

M
We have two other people.

Q: I'll step off and then come back if we have time.

Operator
Thank you. Our next question comes from the line of Evan Tindell with Bireme Capital. Please proceed with your question.

Q: Thanks for taking my call. So, apologies if you guys already talked about this because I missed part of the call. But, what mostly has driven the increase in same-store sales that you guys have been seeing? Is it mostly just attendance in the clubs? Is it pricing?

Eric Langan - President and CEO
It's attendance—to put in the simplest form, we're getting more people in and more people are spending more money. And, when you get both of those, it's really nice. Because, usually what happens, when we get the big guys come in—what I call the whales—the big spend comes in, and we lose a lot of the masses. And when the masses come in, we lose the spending from the big guys simply because it's all economic related. Right now, we're getting both, and we're seeing it and we're liking it. And hopefully, the economy just keeps chugging along here and more people are going back to work and they're coming in the club and spending money. So, it's been great for us.

Q: Are there any clubs where you guys have issues with peak time capacity, where they're just getting too crowded or would that take another 10% or 20% increase in same-store sales before you would be worried about that? One problem that you guys have is that at least with the strip clubs you can't really just build out a location across the street, like a McDonald's would do. Do you worry at all about the actual capacity?

Eric Langan - President and CEO
What we can do is when we get that busy we just raise the prices. I mean, we just raise the prices. Having too much business is a high-class problem. I don't worry about those kinds of problems. I revel in them. Oh, we don't have any parking left, oh, geez, okay, well raise the prices.

So, no, that would give us pricing pressures. We're not that busy because like I said, we're able to pass on the expenses of the increase in liquor costs because everyone else has done it. I think we were late to the ballgame on that. We probably could have raised our prices earlier. But, that may be why we're busier. We waited; we didn't raise our prices as soon as everybody else did. We picked up business because some people were still price-conscious.

I think one of the things that I'm seeing out there and I'm hearing from our guys in the trenches is that people aren't as price-conscious as they have been in the past. In other words, they're coming to have a good time and they don't care if the beer is $4.25 or $4.75, or $5.25. They're not penny-pinching on that anymore like they were especially three or four years ago, and so that's a good sign. That's a good sign that we may have pricing pressures soon where we can increase prices at will if we want, so to speak. We can pass our true cost of liquor or whatever right on to the consumer as soon as it's raised. If taxes are increased or something is increased, we can pass those prices on and keep our profit the same.

We'll see. I think it's early. I think it's still too early. I think right now we're going through an economic experiment, so to speak, with these tax cuts and the way that things are happening in the country right now and in the economy and we're just going to have to wait and see how it all plays out. But, so far it's working well for our industry, the restaurants and the nightclubs.

Q: You mentioned how you are the preferred buyer, the preferred consolidator in the industry. I think that's a great aspect of your story. But, has there been any change, even a small change, in the interest of institutional capital, like private equity firms or anything like that? Or, is it just still crickets from the institutional—

Eric Langan - President and CEO
In our industry, the problem is they have to run them. It's not buying them. Everybody loves the price they can buy our businesses at but they don't like to run them. We've really put down—and that's one of the things we talked about that I'm going to be adding to some of our slide shows and some of our talks—is some of our best practices. We've developed our practices, our best practices, and our formulas on how to run our clubs and how to run these clubs over a long period of time.

So, from somebody coming from the outside and jumping in the first day it seems like a whole lot of fun, but they don't realize we have an in-house legal counsel. We have in-house legal staff; it's not even one person anymore. We have accountants, we have POS and computer systems and a lot of it's proprietary. Some of the stuff we've written or had written for us that manages and controls how our money is handled, how we track all these credit card spends. In the old days it was cash. It was pretty easy. We just copied the casinos, but today it's so much electronic money and electronic transfers. You have to make sure somebody uses your ATM machine and it spits out $40 instead of $60 that they were supposed to get, and you have to keep up with all that. So, creating those systems can become a real nightmare to someone who hasn't been doing it for 25 years.

Q: Last question and I'll let someone else ask. Do the Bombshells usually have a big honeymoon period where they bust out of the gates with the opening day sales, and then it declines by 10% or 20%? Or are they usually pretty close to that, those early sales for the first year? Obviously I'm thinking about the huge success of the Pearland club.

Eric Langan - President and CEO
Typically the first three to six months it can vary. We have that honeymoon. Then it drops off anywhere from 10% to 40% even, depending on what we've seen. And then it takes about a three-month period for it to settle and then start climbing back up. And then by 18 months, we're on a nice normal run rate. So, if you took Pearland, I'd say we're doing $160,000—I'd say we stay at about $150,000+ through the end of June probably, maybe end of July. Then we'll start seeing a little wind off, not a lot, but a little as we move into August.

But then August football picks up, see, so while we get that flow in July, the timing of sports can have a lot to do with how those flows go as well. And so, depending on how hot baseball is going in July, whether there's close races and people are really paying attention to their teams or not, they don't tend to really start getting hot until September as we get towards the end of the season and get into the pennant race.

So, I think we'll get a slow down a little bit in July and then I think we're going to start picking up a little bit in August. September is going to be a little bit better. October is going to be a little bit better. I'd love to see that store level out at about 150 and we can stay there, to be honest with you. I think 120 is a realistic number, 150 is kind of the—if we keep hitting this home run we're going to be there. I think we'd be doing over 160 a week if we had more parking. I mean, it is crazy how the parking was there. It's been a really, really busy store for us.

Q: Thanks, guys.

Operator
Thank you. Seeing as we're getting close to the hour, our final question will be from the line Steve Martin with Slater. Please proceed with your question.

Q: A couple of my questions have been answered. I don't think, I got on a couple minutes late, did you say anything about your quarter-to-date comp?

Eric Langan - President and CEO
Where did we? It's on the slide. I don't think I had mentioned it personally but I know it's on the slide. Slide number—looking real quick, we don't remember off the top of our head. Slide—on page 7 of the slides, 4.8%.

Q: No, that was for the second quarter; I'm saying the third quarter to date.

Eric Langan - President and CEO
No, we have not done anything on third quarter to date, no.

Q: Would you like to give us—take an opportunity?

Eric Langan - President and CEO
Just that it's positive. We are seeing positive. April was positive. Even though we had an extra Sunday/Monday versus five weekends last year, so it's—we're very confident that at this point in the quarter that this quarter will be positive same-source sales again.

Q: Okay. You mentioned that you're not—on the non-GAAP slide that the corporate overhead had come down to $3 million year-over-year from $3.6 million, and it was sequentially down a lot from the first quarter. You indicated that you expected it to continue to decline a little. Where did you—

Eric Langan - President and CEO
No-no. I think it'll go back up a little. I think we'll average out at about $3.3 million or so.

Q: Okay.

Eric Langan - President and CEO
For two quarters. That would be—if I was modeling, that's how I would probably model around—around $3.3 million. We have some added cost due to the internal audit controls firm that we've hired now. We've hired a new firm to come in and really—that's more expert in the ERP sector of this to really lock everything down so we can hopefully get a nice, clean bill of health on our internal control systems from BDO this year in the audit. That's always a concern for me, as you know. We've given some raises, so there's going to be some little

increase in salary and wages as well, and the new store—and more pre-opening costs as we open up I-10 in the next quarter, too.

Q: Rent expense was down from $8.3 million last year to $7.7 million in the first quarter and $7.4 million in the third quarter. Should that continue to drift down as well?

Eric Langan - President and CEO
I think it's going to depend on total revenues. Obviously, if total revenues come down a little bit, that as a percentage will come down, but I think in absolute dollars, yes. It'll continue to come down, so continue to pay off 12% interest graded debt as that debt's amortizing. Of course, that's my favorite saying; everybody says what's up, and most people say the rent, and I say not mine. My rent goes down every time I make a payment. The new loans that we've done, all of the construction loans have been at 5%. The new property purchase loans have been at 5%, so we're still able to get 5% money at this point. I think the next raise hike will probably run us to 5.25% on any new loans, or maybe 5.5% as the banks start tightening up a little bit. But as of right now, they've had some good competition between the banks, and kept our rates around 5%.

Q: All right, and you said you sold a couple of properties. Was that during the quarter or after the quarter?

Eric Langan - President and CEO
Well, we have them under contract. I don't know what's closed and hasn't closed. I'm going to have to get with my assistant and find out where all the close dates are. I know we have some closing dates coming up. I think one is here in June, we may have one coming up at the end of this month. I don't remember, it's on my wall in my office.

Q: Okay. All right—

Eric Langan - President and CEO
We have four properties under contract, of our property held for sale.

Q: Okay, and that'll add to your cash and your war chest for your next acquisition.

Eric Langan - President and CEO
To our cash on some, or pay down some of the bank notes. What we want to do, is we'll probably give all the money—any property that's covered by the Centennial loan, the new $81 million loan—we'll probably have 100% of net proceeds pay straight to the loan, instead of taking the 35% that we can take because we'd rather just pay that down because we want to eliminate that $250,000 a month payment, that additional principle payment that we have to make each month. That'll free up $3 million a year in cash flow for us. Our number one priority right now is to get that extra principal done so we can lower our payment from $874,000 to $524,000 a month on that.

Q: All right. I look forward to seeing you.

Operator
Thank you. You have a follow up question from the line of Darren McCammon with Proactive Financial. Please proceed.

Q: Thanks, guys. On Pearland, it looks like—a number of analysts have talked about this, but on the other stores you were running say $4 million to $5 million, and this one's looking more like $6 million to $8 million. Do you know—revenue, sorry.

Eric Langan - President and CEO

You talking about sales? Yes, okay.

Q: Annual revenue for Pearland.

Eric Langan - President and CEO
I think it's going to come down to about I think $120,000 a week is probably more realistic. We just have some unbelievable sports—for the opening, we had a great opening and a honeymoon for the opening. Plus you had some great sports. The Rockets in the playoffs are definitely helping, and Golden State. All the playoff games have been pretty exciting, especially even Cleveland coming back, and winning. It's—like I said, it's exciting right now that—and baseball's been good for us. The Astros series, like I said, they were playing the Yankees when we first opened, so that helped. That helped those numbers as well.

Q: Okay, so even at $120,000, you're still over $6 million, which is a step up from the other clubs.

Eric Langan - President and CEO
Right. The other locations are going to be—the next four locations are a prototype store. This location [Pearland] is 10,300 square feet inside and 3,100 outside for 13,400 total serving area. Our other locations, the smaller location like 290 are 8,200 inside and about 2,400, so they're only about 10,600 square feet, so they're much smaller serving areas. The idea on those locations are $100,000 a week is our target. We do a little over in the beginning, great. We just don't want to see the locations doing under $100,000. Like I said we're trying to open the stores, they're doing fine. But even if they open at $80,000, we're still doing our $4 million-plus a year, which is still a very profitable store for us.

Q: Okay, so modeling forward, I shouldn't be bumping that up to $6 million or anything; I should keep it at the $4 million, $4.5 million?

Eric Langan - President and CEO
I think between $4.5 million and $5 million right now, with the new locations. Austin's a little bit of a drag. It was one of the early locations that we opened, and if we were to build it today, we would have built it on a different exit than where it's at because of the—because now I understand the flow patterns when people are eating and what they're thinking a little better. But I think all the locations that we are opening now, the next four locations I think are all very top locations, and I would consider an A restaurant location. I think between $4.5 million and $5 million is how I would model them; that's what we're looking for internally.

Q: Under-promise and over-deliver. Okay.

Eric Langan - President and CEO
Maybe, I hope.

Q: I hope too. On cash flow, at what point—how much cash do you guys want to keep on hand?

Eric Langan - President and CEO
Eight million.

Q: I guess what I'm asking is what point do you start putting money towards the debt versus—

Eric Langan - President and CEO
Oh, it depends. Right now, I would be paying down debt if I didn't have acquisitions in the lineup. I have acquisitions in the lineup that I truly believe we will, at least a couple of them we will come to terms on and close

before the end of this year. I don't want to pay off the debt and then have to go borrow it back; that doesn't make sense.

Q: Okay.

Eric Langan - President and CEO
Right now, when we get to $15 million in debt, if we don't start spending it, if we haven't spent it on something, then we'll tend to pay down debt. Basically, what we've done is every time I've gotten to $15 million I went and spent $1 million or so buying more property to do the next Bombshells. Because we had to put 25% down, we buy the dirt. So, we keep getting to $15 million, we get to $16 million or so, we buy something, and then it drops back down. The timing on the other was just—go ahead, sorry.

Q: Okay. That answers. Thank you, I appreciate it.

Operator
It appears there are no further questions at this time. I would like to turn the call back to Gary Fishman for closing comments.

Gary Fishman - IR
Thank you, operator. We've included a couple of supplemental slides in our appendix. Slide 15 is our calendar. A few things coming up. Next week we're meeting with institutional investors in Chicago and Minneapolis on a Stonegate Capital Markets non-deal road show. The following week, we're talking to Darren McCammon, who was just on the call, of the Seeking Alpha Cash Flow Kingdom online newsletter about the possibility of setting up a conference call for his subscribers. We'll publish a webcast URL so other investors can listen in. June is the 35th Anniversary of the opening of the first Rick's Cabaret which changed the face of adult clubs in America, and on July 10th, we'll be reporting third quarter nightclubs and Bombshells sales.

On behalf of Eric, the company and our subsidiaries thank you for listening, and good night. As always, please visit one of our clubs or restaurants. Thank you.