RCI HOSPITALITY HOLDINGS, INC.
Form 10-K
February 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended September 30, 2017

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

Commission file number: 001-13992

RCI HOSPITALITY HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Texas

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

10737 Cutten Road, Houston, Texas 77066

(Address of principal executive offices)

(281) 397-6730

Registrant’s telephone number, including area code

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

Common Stock, $0.01 Par Value

(Title of class)

NASDAQ Stock Market LLC

Name of each exchange on which registered

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [ ] No [X]

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act [ ]

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the registrant's most recently completed second fiscal quarter was $155,616,355.

As of January 31, 2018, there were approximately 9,718,711 shares of common stock outstanding.

NOTE ABOUT FORWARD-LOOKING STATEMENTS

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

TABLE OF CONTENTS

PART I

Item 1. Business.

INTRODUCTION

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

Through our subsidiaries, as of November 30, 2017, we operated a total of 45 establishments that offer live adult entertainment, and/or restaurant and bar operations. We also operated a leading business communications company (the “Media Group”) serving the multibillion-dollar adult nightclubs industry. We have two principal reportable segments: Nightclubs and Bombshells. In the context of club and restaurant/sports bar operations, the terms “Company,” “we,” “our,” “us” and similar terms used in this Form 10-K refer to subsidiaries of RCIHH. Excepting executive officers of RCIHH, any employment referenced in this document is not with RCIHH but solely with one of its subsidiaries. RCIHH was incorporated in the State of Texas in 1994.

Our fiscal year ends on September 30. References to years 2017, 2016 and 2015 are for fiscal years ended September 30, 2017, 2016 and 2015, respectively. Our fiscal quarters chronologically end on December 31, March 31, June 30 and September 30.

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

OUR BUSINESS

We operate several businesses, which we aggregate for financial reporting into two reportable segments – Nightclubs and Bombshells – and combine other operating segments into "Other."

Nightclubs

We operate our nightclubs through the following brands that target many different demographics of customers by providing a unique, quality entertainment environment. Our adult entertainment clubs do business as Rick's Cabaret, Jaguar's Club, Tootsie's Cabaret, XTC Cabaret, Club Onyx, Hoops Cabaret and Sports Bar, Scarlett's Cabaret, Temptations Adult Cabaret, Foxy's Cabaret, Vivid Cabaret, Downtown Cabaret, Cabaret East, The Seville, and Silver City Cabaret. We also operate dance clubs under the brand name Studio 80.

We generate revenue on our nightclubs through the sale of alcoholic beverages, food and merchandise items; service in the form of cover charge, dance fees, and room rentals; and through other related means such as ATM commissions and vending income, among others.

During fiscal 2017, Nightclub segment sales mix was 47% service revenue; 39% alcoholic beverages; and 14% food, merchandise and other, which had a combined segment gross margin (revenues less cost of goods sold) of approximately 87%.

We acquired Hollywood Showclub and other properties in the Greater St. Louis area in April 2017 for a total purchase price of $4.2 million. In May 2017, we acquired Scarlett's Cabaret Miami for a total purchase price of approximately $26.0 million. In July 2017, we relaunched Hollywood Showclub as Scarlett's Cabaret St. Louis, and in August 2017, we opened Hollywood Hunt Club, a 51% joint venture, located on one of the other Greater St. Louis properties we acquired.

A list of our nightclub locations is in Item 2— "Properties."

Bombshells

As of September 30, 2017, our five Bombshells were located in Texas with one in Dallas, one in Austin and three in the Houston area. In 2015, our subsidiary, BMB Franchising Services, Inc. ("BMB Franchising"), announced that it was beginning a nationwide franchising program for Bombshells. As of March 2016, BMB Franchising has received approval to sell franchises in all 50 states. The restaurant sets itself apart with décor that pays homage to all branches of the U.S. military. Locations feature local DJs, large outdoor patios, and more than 75 state-of-the-art flat screen TVs for watching your favorite sports. All food and drink menu items have military names. Bombshell Girls, with their military-inspired uniforms, are a key attraction. Their mission, in addition to waitressing, is to interact with guests and generate a fun atmosphere.

We opened the first Bombshells in March 2013 in Dallas, quickly becoming one of the most popular restaurant destinations in the area. Within a year, four more opened in the Austin and Houston, Texas areas. Of the five, three are freestanding pad sites and two are inline locations. In September 2016, we closed one Bombshells location in Webster, Texas. In July 2017, we opened another Bombshells location in Houston.

During fiscal 2017, sales mix was 63% alcoholic beverages and 37% food, merchandise and other, which had a combined segment gross margin (revenues less cost of goods sold) of 75%.

For a list of our Bombshells locations, refer to Item 2—"Properties."

Media Group

The Media Group, made up of wholly-owned subsidiaries, is the leading business communications company serving the multibillion-dollar adult nightclubs industry and the adult retail products industry. It owns a national industry convention and tradeshow; two national industry trade publications; two national industry award shows; and more than a dozen industry and social media websites. Included in the Media Group is ED Publications, publishers of the bimonthly ED Club Bulletin, the only national business magazine serving the 2,200-plus adult nightclubs in North America, which collectively have annual revenues in excess of $5 billion, according to the Association of Club Executives. ED Publications, founded in 1991, also publishes the Annual VIP Guide of adult nightclubs, touring entertainers and industry vendors; produces the Annual Gentlemen's Club Owners EXPO, a national convention and tradeshow; and offers the exclusive ED VIP Club Card, honored at more than 850 adult nightclubs. The Media Group produces two nationally recognized industry award shows for the readers of both ED Club Bulletin and StorErotica magazines, and maintains a number of B-to-B and consumer websites for both industries.

OUR STRATEGY

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

Capital Allocation Strategy

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

Based on our current capital allocation strategy:

- We consider acquiring or developing our own clubs or restaurants that we believe have the potential to provide a minimum cash on cash return of 25%-33%, absent an otherwise strategic rationale;
- We consider disposing of underperforming units to free up capital for more productive use;
- We consider buying back our own stock if the after-tax yield on free cash flow climbs over 10%;
- We consider paying down our most expensive debt if it makes sense on a tax adjusted basis, or there is an otherwise strategic rationale.

COMPETITION

The adult entertainment and the restaurant/sports bar businesses are highly competitive with respect to price, service and location. All of our nightclubs compete with a number of locally owned adult clubs, some of whose brands may have name recognition that equals that of ours. The names "Rick's" and "Rick's Cabaret," "Tootsie's Cabaret," "XTC Cabaret, "Scarlett's," "Silver City," "Club Onyx," "Downtown Cabaret," "Temptations," "The Seville," "Jaguars," "Hoops Cabaret," an Cabaret" are proprietary. In the restaurant/sports bar business, "Bombshells" is also proprietary. We believe that the combination of our existing brand name recognition and the distinctive entertainment environment that we have created allows us to compete effectively in the industry and within the cities where we operate. Although we believe that we are well positioned to compete successfully, there can be no assurance that we will be able to maintain our high level of name recognition and prestige within the marketplace.

GOVERNMENTAL REGULATIONS

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

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

TRADEMARKS

Our rights to the trade names "RCI Hospitality Holdings, Inc.," "Rick's," "Rick's Cabaret," "Tootsie's Cabaret," "Club Onyx," "XTC Cabaret," "Temptations," "Jaguars," "Downtown Cabaret," "Cabaret East," Bombshells Restaurant and Bar," and "Vee Lounge" are established under common law, based upon our substantial and continuous use of these trade names in interstate commerce, some of which have been in use at least as early as 1987. We have registered our service mark, "RICK'S AND STARS DESIGN," and the "BOMBSHELLS RESTAURANT & BAR" logo design with the United States Patent and Trademark Office. We have also obtained service mark registrations from the Patent and Trademark Office for "RICK'S AND STARS DESIGN" logo, "RCI HOSPITALITY HOLDINGS, INC.," "RICKS," "RICK'S CABARET," "CLUB ONYX," "XTC CABARET," "SCARLETT'S CABARET," "SILVER CITY CABARET," "BOMBSHELLS RESTAURANT AND BAR", "THE SEVILLE CLUB", "DOWN IN TEXAS SALOON", "CLUB DULCE", "THE BLACK ORCHID", "HOOPS CABARET", "STUDIO 80", "FOXY'S CABARET" and "EXOTIC DANCER" are registered through service mark registrations issued by the United States Patent and Trademark Office. As of this date, we have pending registration applications for the name "TOOTSIES CABARET" We also own the rights to numerous trade names associated with our media division. There can be no assurance that these steps we have taken to protect our service marks will be adequate to deter misappropriation of our protected intellectual property rights.

EMPLOYEES AND INDEPENDENT CONTRACTORS

As of September 30, 2017, we had approximately 2,130 employees, of which approximately 180 are in management positions, including corporate and administrative operations, and approximately 1,950 are engaged in entertainment, food and beverage service, including bartenders, waitresses, and certain entertainers. None of our employees are represented by a union. We consider our employee relations to be good. Additionally, as of September 30, 2017, we had independent contractor entertainers, who are self-employed and conduct business at our locations on a non-exclusive basis. Our entertainers at Rick's Cabaret in Minneapolis, Minnesota and at Jaguars Club in Phoenix, Arizona act as commissioned employees. All employees and independent contractors sign arbitration non-class action participation agreements.

We believe that the adult entertainment industry standard of treating entertainers as independent contractors provides us with safe harbor protection to preclude payroll tax assessment for prior years. We have prepared plans that we believe will protect our profitability in the event that the sexually oriented business industry is required in all states to convert entertainers, who are now independent contractors, into employees. See related discussion in "Risk Factors."

Item 1A. Risk Factors.

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

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

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

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

Our nightclubs are often acquired with a purchase price based on historical EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). This results in certain nightclubs carrying a substantial amount of intangible value, mostly allocated to licenses and goodwill. Generally accepted accounting principles require an annual impairment review of these indefinite-lived intangible assets. As a result of our annual impairment review, we recorded impairment charges of $7.6 million in 2017 (including $4.7 million of goodwill impairment on three operating clubs and one property held for sale, $385,000 of property and equipment impairment on one operating club, $1.4 million of license impairment on two clubs, and $1.2 million of other-than-temporary impairment recognized on our cost method investment in Robust), $3.5 million in 2016 (including $1.4 million in one of our properties held for sale and $2.1 million of license impairment on one club), and $1.7 million in 2015 (for license impairment of two clubs). If difficult market and economic conditions materialize over the next year and/or we experience a decrease in revenue at one or more nightclubs, we could incur a decline in fair value of one or more of our nightclubs. This could result in future impairment charges of up to the total value of the indefinite-lived intangible assets.

We may deviate from our present capital allocation strategy.

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

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

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

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

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

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

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

The adult entertainment industry is extremely volatile.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In addition, the Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting and effective disclosure controls and procedures. In particular, under Section 404 of the Sarbanes-Oxley Act, we are required to perform system and process evaluation and testing on the effectiveness of our internal control over financial reporting, and our independent registered public accounting firm is required to report on the effectiveness of our internal control over financial reporting. In performing this evaluation and testing, both our management and our independent registered public accounting firm concluded that our internal control over financial reporting is not effective as of September 30, 2017 because of certain material weaknesses. We are, however, addressing these issues and updating our policies and procedures. Upon finalizing these policies and procedures and ensuring they are effectively applied, we believe our internal control will be deemed effective. Correcting this issue, and thereafter our continued compliance with Section 404 will require that we incur substantial accounting expense and expend significant management efforts. Moreover, if we are not able to correct our internal control issues and comply with the requirements of Section 404 in a timely manner, or if in the future we or our independent registered public accounting firm identifies deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline, and we could be subject to sanctions or investigations by the SEC or other regulatory authorities, which would require additional financial and management resources.

We have identified material weaknesses in our internal control over financial reporting

Management, including our Chief Executive Officer and our Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting as of September 30, 2017 and concluded that we did not maintain effective internal control over financial reporting. Specifically, management identified material weaknesses over (1) certain information technology application and general computer controls, (2) complex accounting matters related to assets held for sale, business combinations, cost method investments, income taxes, and the impairment analyses for indefinite-lived intangible assets, goodwill, and property and equipment, and (3) financial reporting and disclosures—see Item 9A, “Controls and Procedures,” below. While certain actions have been taken to implement a remediation plan to address these material weaknesses and to enhance our internal control over financial reporting, if these material weaknesses are determined to have not been remediated, it could adversely affect our ability to report our financial condition and results of operations in a timely and accurate manner, which could negatively affect investor confidence in our company, and, as a result, the value of our common stock could be adversely affected.

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

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

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

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

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

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

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

On April 10, 2014, the Court of Chancery of the State of Delaware entered a Liquidation and Injunction Order With Bar Date (“Liquidation Order”), which ordered the liquidation of IIC and terminated all insurance policies or contracts of insurance issued by IIC. The Liquidation Order further ordered that all claims against IIC must have been filed with the Receiver before the close of business on January 16, 2015 and that all pending lawsuits involving IIC as the insurer were further stayed or abated until October 7, 2014. As a result, the Company and its subsidiaries no longer had insurance coverage under the liability policy with IIC. Currently, there are several civil lawsuits pending against the Company and its subsidiaries. The Company has retained counsel to defend against and evaluate these claims and lawsuits. We are funding 100% of the costs of litigation and will seek reimbursement from the bankruptcy receiver. The Company filed the appropriate claims against IIC with the Receiver before the January 16, 2015 deadline and has provided updates as requested; however, there are no assurances of any recovery from these claims. It is unknown at this time what effect this uncertainty will have on the Company. As previously stated, since October 25, 2013, the Company obtained general liability coverage from other insurers, which have covered and/or will cover any claims arising from actions after that date. We have 8 unresolved cases left out of the original 71 cases.

The protection provided by our service marks is limited.

Our rights to the trade names “RCI Hospitality Holdings, Inc.,” “Rick’s,” “Rick’s Cabaret,” “Tootsie’s Cabaret,” “Club Onyx,” “XTC Cabaret,” “Temptations,” “Jaguars,” “Downtown Cabaret,” “Cabaret East,” “Bombshells Restaurant and Bar,” and “Vee Lounge” are established under common law, based upon our substantial and continuous use of these trade names in interstate commerce, some of which have been in use at least as early as 1987. “RICK’S AND STARS DESIGN” logo, “RCI HOSPITALITY HOLDINGS, INC.,” “RICKS,” “RICK’S CABARET,” “CLUB ONYX,” “XTC CABARET,” “SCARLETT’S CABARET,” “SILVER CITY CABARET,” “BOMBSHELLS RESTAURANT AND BAR,” “THE SEVILLE CLUB,” “DOWN IN TEXAS SALOON,” “THE BLACK ORCHID,” “HOOPS CABARET,” “STUDIO 80,” “FOXY’S CABARET,” “CLUB DULCE” and “EXOTIC DANCER” are registered through service mark registrations issued by the United States Patent and Trademark Office. As of this date, we have pending registration application for the name “TOOTSIE’S CABARET.” We also own the rights to numerous trade names associated with our media division. There can be no assurance that these steps we have taken to protect our service marks will be adequate to deter misappropriation of our protected intellectual property rights. Litigation may be necessary in the future to protect our rights from infringement, which may be costly and time consuming. The loss of the intellectual property rights owned or claimed by us could have a material adverse effect on our business.

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

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

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

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

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

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

- our performance and prospects;
- the depth and liquidity of the market for our securities;
- sales by selling shareholders of shares issued or issuable in connection with certain convertible notes;
- investor perception of us and the industry in which we operate;
- changes in earnings estimates or buy/sell recommendations by analysts;
- general financial and other market conditions; and
- domestic economic conditions.

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

We are dependent on key personnel.

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

Cumulative voting is not available to our stockholders.

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

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

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

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

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

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

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

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

Recently enacted legislation may significantly affect our results of operations, cash flows and financial condition.

On December 22, 2017, the Tax Cuts and Jobs Act ("Tax Act") was signed into law. The Tax Act contains significant changes to corporate taxation, including reduction of the corporate tax rate from 35% to 21%, additional limitations on the tax deductibility of interest, immediate deductions for certain new investments instead of deductions for depreciation expense over time, and modification or repeal of many business deductions and credits. Notwithstanding the reduction in the corporate income tax rate, the overall impact of the Tax Act is uncertain, and our results of operations, cash flows and financial condition, as well as the trading price of our common stock, could be adversely affected.

Other risk factors may adversely affect our financial performance.

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

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

We currently own 46 real estate properties. On 32 of these properties, we operate clubs or restaurants. We lease multiple other properties to third-party tenants. Four of our owned properties are locations where we previously operated clubs but now lease the buildings to third parties. Four are non-income producing properties for corporate use, including our corporate office. Three other properties are currently offered for sale. The remaining three properties are for two under construction future Bombshells sites and one adjacent property that may be offered for sale in the future. Thirteen of our clubs and restaurants are in leased locations.

Our principal corporate office is located at 10737 Cutten Road, Houston, Texas 77066, consisting of a 21,000-square foot corporate office and an 18,000-square foot warehouse facility.

Below is a list of locations we operate:

Name of Establishment	Year Acquired/Opened	
Club Onyx, Houston, TX	1995	
Rick’s Cabaret, Minneapolis, MN	1998	
XTC Cabaret, Austin, TX	1998	
XTC Cabaret, San Antonio, TX	1998	
XTC Cabaret, Houston, TX	2004	(2)
Rick’s Cabaret, New York City, NY	2005	
Club Onyx, Charlotte, NC	2005	(2)
Rick’s Cabaret, San Antonio, TX	2006	
XTC Cabaret, South Houston, TX	2006	(2)
Rick’s Cabaret, Fort Worth, TX	2007	
Tootsie’s Cabaret, Miami Gardens, FL	2008	
XTC Cabaret, Dallas, TX	2008	
Club Onyx, Dallas, TX	2008	
Club Onyx, Philadelphia, PA	2008	
Rick’s Cabaret, Round Rock, TX	2009	
Cabaret East, Fort Worth, TX	2010	
Rick’s Cabaret DFW, Fort Worth, TX	2011	
Downtown Cabaret, Minneapolis, MN	2011	
Temptations, Aledo, TX	2011	(2)
Silver City Cabaret, Dallas, TX	2012	
Jaguars Club, Odessa, TX	2012	
Jaguars Club, Phoenix, AZ	2012	
Jaguars Club, Lubbock, TX	2012	
Jaguars Club, Longview, TX	2012	
Jaguars Club, Tye, TX	2012	
Jaguars Club, Edinburg, TX	2012	
Jaguars Club, El Paso, TX	2012	
Jaguars Club, Harlingen, TX	2012	
Studio 80, Fort Worth, TX	2013	(2)
Bombshells, Dallas, TX	2013	
Temptations, Sulphur, LA	2013	
Temptations, Beaumont, TX	2013	
Vivid Cabaret, New York, NY	2014	(2)
Bombshells, Austin, TX	2014	(2)
Rick’s Cabaret, Odessa, TX	2014	
Bombshells, Spring TX	2014	(2)
Bombshells, Houston, TX	2014	(2)
Foxy’s Cabaret, Austin TX	2015	
The Seville, Minneapolis, MN	2015	
Hoops Cabaret and Sports Bar, New York, NY	2016	(2)
Studio 80, Webster, TX	2017	(1)(2)

Bombshells, Highway 290 Houston, TX	2017	(2)
Scarlett's Cabaret, Washington Park, IL	2017	
Scarlett's Cabaret, Miami, FL	2017	(2)
Hollywood Hunt Club, Centerville, IL	2017	

(1) Reconcepted in 2017.

(2) Leased location.

Our property leases are typically for a fixed rental rate without revenue percentage rentals. The lease terms generally have initial terms of 10 to 20 years with renewal terms of 5 to 20 years. At September 30, 2017, certain of our owned properties were collateral for mortgage debt amounting to approximately $74.8 million. Also, see more information in Notes 5, 8 and 11 to our consolidated financial statements.

Item 3. Legal Proceedings.

See the “Legal Matters” section within Note 11 to our consolidated financial statements within this Annual Report on Form 10-K for the requirements of this Item, which section is incorporated herein by reference.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

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

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

COMMON STOCK PRICE RANGE	High	Low
Fiscal Year Ended September 30, 2017		
First Quarter	$17.99	$10.92
Second Quarter	$18.00	$16.02
Third Quarter	$25.47	$16.32
Fourth Quarter	$26.85	$21.91
Fiscal Year Ended September 30, 2016		
First Quarter	$10.75	$9.38
Second Quarter	$9.94	$7.50
Third Quarter	$11.10	$8.77
Fourth Quarter	$11.60	$9.90

On January 31, 2018, the closing stock price for our common stock as reported by NASDAQ was $29.38. On January 31, 2018, there were approximately 164 stockholders of record of our common stock (excluding broker held shares in "street name"). We estimate that there are approximately 6,500 stockholders having beneficial ownership in street name.

TRANSFER AGENT AND REGISTRAR

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

DIVIDEND POLICY

Prior to 2016, we have not paid cash dividends on our common stock. Starting in March 2016, in conjunction with our share buyback program (see discussion below), our Board of Directors has declared quarterly cash dividends of $0.03 per share ($0.12 per share on an annual basis). During fiscal 2017 and 2016, we paid an aggregate amount of $1.2 million and $862,000, respectively, for cash dividends.

PURCHASES OF EQUITY SECURITIES BY THE ISSUER

During the fiscal year ended September 30, 2017, we purchased a total of 89,685 shares of common stock in the open market at prices ranging from $11.24 to $13.87. As of September 30, 2017, we have $3.1 million remaining to purchase additional shares.

We did not repurchase shares of the Company’s common stock during the three months ended September 30, 2017.

EQUITY COMPENSATION PLAN INFORMATION

We have no stock options nor any other equity award outstanding under equity compensation plans as of September 30, 2017.

STOCK PERFORMANCE GRAPH

The following chart compares the 5-year cumulative total stock performance of our common stock; the NASDAQ Composite Index (IXIC); the Russell 2000 Index (RUT) and the Dow Jones U.S. Restaurant & Bar Index (DJUSRU), our peer index. The graph assumes a hypothetical investment of $100 on September 30, 2012 in each of our common stock and each of the indices, and that all dividends were reinvested. The measurement points utilized in the graph consist of the last trading day as of September 30 each year, representing the last day of our fiscal year. The calculations exclude trading commissions and taxes. We have selected the Dow Jones U.S. Restaurant & Bar Index as our peer index since it represents a broader group of restaurant and bar operators that are more aligned to our core business operations. RICK is a component of both the NASDAQ Composite Index and the Russell 2000 Index. The historical stock performance presented below is not intended to and may not be indicative of future stock performance.

Item 6. Selected Financial Data.

The following tables set forth certain of the Company's historical financial data. The selected historical consolidated financial position data as of September 30, 2017 and 2016 and results of operations data for the years ended September 30, 2017, 2016 and 2015 have been derived from the Company's audited consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. The selected historical consolidated financial data as of September 30, 2015, 2014 and 2013 and for the years ended September 30, 2014 and 2013 have been derived from the Company's audited financial statements for such years, as revised (see footnote 3 below), which are not included in this Annual Report on Form 10-K. The selected historical consolidated financial data set forth are not necessarily indicative of the results of future operations and should be read in conjunction with the discussion under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the historical consolidated financial statements and accompanying notes included herein. The historical results are not necessarily indicative of the results to be expected in any future period.

Please read the following selected consolidated financial data in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes appearing elsewhere in this Annual Report on Form 10-K for a discussion of information that will enhance understanding of these data (in thousands, except per share data and percentages).

<u>Financial Statement Data:</u>

	Years Ended September 30,				
	2017	2016	2015	2014	2013
Revenue(1)	$144,896	$134,860	$135,449	$121,432	$105,921
Income from operations(3)	$23,139	$20,693	$20,727	$18,875	$21,883
Net income attributable to RCIHH(3)	$8,259	$11,218	$9,214	$11,161	$9,191
Diluted earnings per share	$0.85	$1.11	$0.89	$1.13	$0.96
Capital expenditures	$11,249	$28,148	$19,259	$16,034	$9,675
Dividends declared per share	$0.12	$0.09	$-	$-	$-

	September 30,				
	2017	2016	2015	2014	2013
Cash and cash equivalents	$9,922	$11,327	$8,020	$9,964	$10,638
Total current assets(3)	$26,242	$29,387	$16,935	$17,973	$16,042
Total assets(3)	$299,884	$276,061	$266,527	$233,383	$218,242
Total current liabilities (excluding current portion of long-term debt)(3)	$13,671	$17,087	$15,580	$28,527	$20,083
Long-term debt (including current portion)	$124,352	$105,886	$94,349	$70,092	$78,352

Total liabilities(3)	$164,659	$146,722	$138,973	$120,918	$121,127
Total RCIHH stockholders' equity(3)	$132,745	$126,755	$121,691	$109,455	$93,781
Common shares outstanding	9,719	9,808	10,285	10,067	9,504

Non-GAAP Measures and Other Data:

	Years Ended September 30,				
	2017	2016	2015	2014	2013
Adjusted EBITDA(2)	$37,348	$34,531	$34,125	$31,703	$27,733
Non-GAAP operating income(2)(3)	$30,668	$27,566	$27,974	$25,762	$23,864
Non-GAAP operating margin(2)(3)	21.2 %	20.4 %	20.7 %	21.2 %	22.5 %
Non-GAAP net income(2)(3)	$13,953	$13,302	$13,873	$11,882	$10,780
Non-GAAP diluted net income per share(2)(3)	$1.43	$1.32	$1.34	$1.19	$1.13
Free cash flow(2)	$19,281	$20,513	$14,889	$18,734	$17,153
Same-store sales	4.9 %	-1.3 %	-1.5 %	2.8 %	-1.2 %

(1) Due to a change in accounting policy, we have reported revenues net of sales taxes and other revenue related taxes since the beginning of fiscal 2016. Prior year revenues and expenses have been revised to reflect this change. Refer to Note 2 to the consolidated financial statements for further discussion.

(2) Reconciliation and discussion of non-GAAP financial measures are included under the "Non-GAAP Financial Measures" section of Item 7 – "Management's Discussion and Analysis of Financial Condition and Results of Operations" that follows. See also notes on comparability of adjustment items at the end of this section. These measures should be considered in addition to, rather than as a substitute for, U.S. GAAP measures.

(3) We revised the financial statements for the years ended September 30, 2016, 2015 and 2014 due to misstatements that could have been material if corrected cumulatively in the current year. See Note 3 to the consolidated financial statements for details.

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

OVERVIEW

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

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

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

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

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

OUR BUSINESS

The following are our operating segments:

Nightclubs	Our wholly-owned subsidiaries own and/or operate upscale adult nightclubs serving primarily businessmen and professionals. These nightclubs are in Houston, Austin, San Antonio, Dallas, Fort Worth, Beaumont, Longview, Harlingen, Edinburg, Tye, Lubbock, El Paso and Odessa, Texas; Charlotte, North Carolina; Minneapolis, Minnesota; New York, New York; Miami Gardens and Pembroke Park, Florida; Philadelphia, Pennsylvania; Phoenix, Arizona; and Washington Park, Illinois. No sexual contact is permitted at any of our locations. We also own and operate Studio 80 dance clubs in Fort Worth and Webster, Texas.
Bombshells	Our wholly-owned subsidiaries own and operate non-adult nightclubs, restaurants, and sports bars in Houston, Dallas, Austin and Spring, Texas under the brand name Bombshells Restaurant & Bar.

Media Group	Our wholly-owned subsidiaries own a media division, including the leading trade magazine serving the multibillion-dollar adult nightclubs industry and the adult retail products industry. We also own an industry trade show, an industry trade publication and more than a dozen industry and social media websites.

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

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

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

A full discussion of our significant accounting policies is contained in Note 2 to our consolidated financial statements, which is included in Item 8 – "Financial Statements and Supplementary Data" of this report. We believe that the following accounting estimates are the most critical to aid in fully understanding and evaluating our financial results. These estimates require our most difficult, subjective or complex judgments because they relate to matters that are inherently uncertain. We have reviewed these critical accounting policies and estimates and related disclosures with our Audit Committee.

Long-Lived Assets

We review long-lived assets, such as property and equipment, and intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. These events or changes in circumstances include, but are not limited to, significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of the acquired assets or the strategy for the overall business, and significant negative industry or economic trends. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset group to the estimated undiscounted cash flows over the estimated remaining useful life of the asset group. If the asset group is not recoverable, the impairment loss is calculated as the excess of the carrying value over the fair value. We define our asset group as an operating club or restaurant location, which is also our reporting unit or the lowest level for which cash flows can be identified. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. During the fourth quarter of fiscal 2017, we impaired one club by $385,000, and during the fourth quarter of fiscal 2016, we impaired one property held for sale by $1.4 million.

Investment

During the fourth quarter of fiscal 2017, we also fully impaired our remaining investment in Drink Robust amounting to $1.2 million.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets that have indefinite useful lives are tested annually for impairment during our fourth fiscal quarter, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired.

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

For our goodwill impairment review, we first perform a qualitative assessment to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying value. This assessment is based on several factors, including industry and market conditions, overall financial performance, including an assessment of cash flows in comparison to actual and projected results of prior periods. If it is determined that it is more likely than not that the fair value of a reporting unit is less than its carrying value based on our qualitative analysis, we perform a Step 1 analysis to determine the fair value of the reporting unit. The fair value is determined using market-related valuation models, including earnings multiples, discounted cash flows, and comparable asset market values. As detailed within Note 2 of our consolidated financial statements, we adopted ASU 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, during Q4 of 2017, and accordingly, we recognize goodwill impairment in the amount that the carrying value of the reporting unit exceeds the fair value of the reporting unit, not to exceed the amount of goodwill allocated to the reporting unit, based on the results of our Step 1 analysis. For the year ended September 30, 2017, we identified four reporting units that were impaired and recognized a goodwill impairment loss totaling $4.7 million.

For indefinite-lived intangibles, specifically SOB licenses, we determine fair value by estimating the multiperiod excess earnings of the asset. For indefinite-lived tradename, we determine fair value by using the relief from royalty method. The fair value is then compared to the carrying value and an impairment charge is recognized by the amount by which the carrying amount exceeds the fair value of the asset. We recorded impairment charges for SOB licenses amounting to $1.4 million for 2017, $2.1 million for 2016 and $1.7 million for 2015, related to two clubs in 2017, one club in 2016 and two clubs in 2015.

Income Taxes

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

On December 22, 2017, the Tax Act was signed into law. The Tax Act contains significant changes to corporate taxation, including reduction of the corporate tax rate from 35% to 21%, additional limitations on the tax deductibility of interest, immediate deductions for certain new investments instead of deductions for depreciation expense over time, and modification or repeal of many business deductions and credits. Our annual effective tax rate will be adjusted in our first quarter ended December 31, 2017, the period when the Tax Act has been enacted.

Legal and Other Contingencies

As mentioned in Item 3 – "Legal Proceedings" and in a more detailed discussion in Note 11 to our consolidated financial statements, we are involved in various suits and claims in the normal course of business. We record a liability when it is probable that a loss has been incurred and the amount is reasonably estimable. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In the opinion of management, there was not at least a reasonable possibility that we may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for asserted legal and other claims. However, the outcome of legal proceedings and claims brought against the Company is subject to significant uncertainty. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a reporting period for amounts in excess of management's expectations, the Company's consolidated financial statements for that reporting period could be materially adversely affected.

OPERATIONS REVIEW

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

	2017	2016	2015
Sales of alcoholic beverages	41.7 %	42.4 %	41.2 %
Sales of food and merchandise	12.6 %	13.3 %	13.8 %
Service revenues	40.1 %	38.0 %	39.1 %
Other	5.6 %	6.3 %	5.8 %
Total revenues	100.0%	100.0%	100.0%
Cost of goods sold			
Alcoholic beverages	21.7 %	22.1 %	21.6 %
Food and merchandise	40.5 %	38.0 %	39.9 %
Service and other	0.3 %	1.9 %	1.3 %
Total cost of goods sold (exclusive of items shown separately below)	14.3 %	15.2 %	15.0 %
Salaries and wages	27.6 %	27.8 %	27.9 %
Selling, general and administrative	32.3 %	31.9 %	32.2 %
Depreciation and amortization	4.8 %	5.4 %	5.2 %
Other charges	5.0 %	4.3 %	4.5 %
Total operating expenses	84.0 %	84.7 %	84.7 %
Income from operations	16.0 %	15.3 %	15.3 %
Interest expense	-6.0 %	-5.9 %	-5.1 %
Interest income	0.2 %	0.1 %	0.0 %
Non-operating gains	0.0 %	0.0 %	0.2 %
Income before income taxes	10.1 %	9.5 %	10.3 %
Income taxes	4.4 %	1.8 %	3.8 %
Net income	5.7 %	7.8 %	6.6 %

* Percentages may not foot due to rounding. Percentage of revenue for individual cost of goods sold items pertains to their respective revenue line.

We have revised prior year financial statements to correct certain misstatements that could have a material impact if corrected cumulatively in the current year. See Note 3 to the consolidated financial statements for details.

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

	Increase (Decrease)			
	2017 vs. 2016		2016 vs. 2015	
	Amount	%	Amount	%
Sales of alcoholic beverages	$3,223	5.6 %	$1,387	2.5 %
Sales of food and merchandise	356	2.0 %	(813)	-4.3 %
Service revenues	6,856	13.4 %	(1,738)	-3.3 %
Other	(399)	-4.7 %	575	7.3 %
Total revenues	10,036	7.4 %	(589)	-0.4 %
Cost of goods sold				
Alcoholic beverages	490	3.9 %	588	4.9 %
Food and merchandise	588	8.6 %	(657)	-8.8 %
Service and other	(903)	-81.2 %	298	36.6 %
Total cost of goods sold (exclusive of items shown separately below)	175	0.9 %	229	1.1 %
Salaries and wages	2,572	6.9 %	(275)	-0.7 %
Selling, general and administrative	3,700	8.6 %	(523)	-1.2 %
Depreciation and amortization	(408)	-5.6 %	283	4.0 %
Other charges, net	1,551	26.9 %	(269)	-4.5 %
Total operating expenses	7,590	6.6 %	(555)	-0.5 %
Income from operations	2,446	11.8 %	(34)	-0.2 %
Interest expense	(782)	9.8 %	(1,013)	14.5 %
Interest income	135	103.1 %	116	773.3 %
Non-operating gains	-	0.0 %	(229)	-100.0 %
Income before income taxes	1,799	14.0 %	(1,160)	-8.3 %
Income taxes	3,986	168.0 %	(2,738)	-53.6 %
Net income	$(2,187)	-20.9 %	$1,578	17.7 %

Revenues

Our total consolidated revenues for fiscal 2017 amounted to $144.9 million compared to $134.9 million for fiscal 2016 and $135.4 million for fiscal 2015. The increase of $10.0 million, or 7.4%, from 2016 to 2017 was primarily due to 7.4% increase in new or reconcepted locations and the impact of the 4.9% full year increase in same-store sales, partially offset by a 3.8% decrease from closed locations and a minimal decrease from other revenue items. The

$589,000, or 0.4%, decrease from 2015 to 2016 was primarily due to the impact of the 1.3% decrease in same-store sales partially offset by an increase in rental income and sale of energy drinks.

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

	2017	**2016**	**2015**
Business segment revenues:			
Nightclubs	$124,687	$113,941	$115,493
Bombshells	18,830	18,690	17,639
Other	1,379	2,229	2,317
	$144,896	$134,860	$135,449

Nightclubs revenues increased by 9.4% from 2016 to 2017, while decreasing by 1.3% from 2015 to 2016. A breakdown of the changes is as follows:

	2017 vs. 2016	2016 vs. 2015
Impact of 5.1% increase and 2.3% decrease in same-store sales, respectively	4.8 %	(2.2 %)
New and reconcepted units	7.7 %	1.4 %
Closed units	(3.2 %)	(1.1 %)
Other	0.1 %	0.5 %
	9.4 %	(1.3 %)

Included in 2017 new units are clubs acquired in the third quarter of 2017, Scarlett’s Cabaret Miami and Hollywood Showclub (the latter now relaunched and rebranded as Scarlett’s Cabaret St. Louis), which contributed a combined $5.6 million in revenues since the acquisition dates.

Bombshells revenues increased by 0.7% from 2016 to 2017, and increased by 6.0% from 2015 to 2016. A breakdown of the changes is as follows:

	2017 vs. 2016	2016 vs. 2015
Impact of 3.5% and 5.1% increase in same-store sales, respectively	3.2 %	4.8 %
New units	5.8 %	1.2 %
Closed units	(8.3 %)	0.0 %
	0.7 %	6.0 %

Bombshells Webster was closed toward the end of the fourth quarter of 2016, while Bombshells 290 was opened early in the fourth quarter of 2017.

Other revenues included revenues from Drink Robust, which was sold during the fourth quarter of 2016.

Operating Expenses

Total operating expenses, as a percent of revenues, were 84.0%, 84.7% and 84.7% for the fiscal year 2017, 2016 and 2015, respectively. Significant contributors to the change in operating expenses as a percent of revenues are explained below.

Cost of goods sold includes cost of alcoholic and non-alcoholic beverages, food, cigars and cigarettes, merchandise, media printing/binding and media. As a percentage of revenues, total cost of goods sold was 14.3%, 15.2% and 15.0%, respectively, mainly due to the increase in service revenue in the mix, which contributes a higher gross margin. See above for breakdown of percentages for each line item of cost of goods sold as it relates to the respective revenue line.

Salaries and wages increased by $2.6 million, or 6.9%, from 2016 to 2017, and decreased by $275,000, or 0.7%, from 2015 to 2016. The increase from 2016 to 2017 was mainly due to additional corporate headcount to support the commencement of our franchising effort, our return to a growth model (see discussion in our Growth Strategy section below), and a shift to employee status of certain entertainers in Minneapolis and Phoenix (as discussed in the Business section above). As a percentage of revenues, salaries and wages remained relatively flat at 27.6%, 27.8% and 27.9% for fiscal year 2017, 2016 and 2015, respectively.

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

	Years Ended September 30,			**Percentage of Revenues**		
	2017	**2016**	**2015**	**2017**	**2016**	**2015**
Taxes and permits	$8,026	$8,089	$8,031	5.5 %	6.0 %	5.9 %
Advertising and marketing	6,704	5,374	5,610	4.6 %	4.0 %	4.1 %
Supplies and services	4,873	4,815	4,726	3.4 %	3.6 %	3.5 %
Insurance	4,006	3,575	3,364	2.8 %	2.7 %	2.5 %
Rent	3,258	3,278	4,526	2.2 %	2.4 %	3.3 %
Legal	3,074	3,130	3,556	2.1 %	2.3 %	2.6 %
Utilities	2,824	2,871	2,999	1.9 %	2.1 %	2.2 %
Charge card fees	2,783	2,252	2,176	1.9 %	1.7 %	1.6 %
Security	2,251	2,042	1,905	1.6 %	1.5 %	1.4 %
Accounting and professional fees	2,159	1,353	1,025	1.5 %	1.0 %	0.8 %
Repairs and maintenance	2,091	2,088	1,916	1.4 %	1.5 %	1.4 %
Other	4,726	4,208	3,764	3.3 %	3.1 %	2.8 %
	$46,775	$43,075	$43,598	32.3%	31.9%	32.2%

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

Advertising and marketing increased by $1.3 million, or 24.7%, from 2016 to 2017 mainly due to the acquisition of Scarlett's Miami in the third quarter of 2017 and the additional spending in relation to increase in revenues, and decreased by $236,000, or 4.2%, from 2015 to 2016 primarily due to reduced spending on live entertainment in Bombshells and marketing support reimbursement in our Media Group. As a percentage of revenues, advertising and marketing was 4.6%, 4.0 and 4.1% for 2017, 2016 and 2015, respectively.

Insurance increased by $431,000, or 12.1%, from 2016 to 2017, and $211,000, or 6.3%, from 2015 to 2016 primarily due to an increase in general liability insurance premiums.

Rent expense decreased by $1.2 million, or 27.6% from 2015 to 2016 principally due to the acquisition of the New York property in 2015 through 2016. Prior to the New York property acquisition, the location's annual average rent expense was $1.1 million for the last three years. As a percentage of revenues, rent expense has gone down to 2.2% in 2017 from 2.4% in 2016 and 3.3% in 2015.

Legal expenses decreased by $426,000, or 12.0%, from 2015 to 2016 primarily due to decreased legal activity and settlement after the New York labor lawsuit.

Charge card fees increased by $531,000, or 23.6%, from 2016 to 2017, and had an immaterial change from 2015 to 2016. The increase from 2016 to 2017 was mainly from additional revenues caused by higher same-store sales and the acquisition of two new clubs in 2017. As a percentage of revenues, charge card fees have remained flat at 1.9%, 1.7% and 1.6% in 2017, 2016 and 2015, respectively.

Accounting and professional fees increased by $806,000, or 59.6%, from 2016 to 2017, and $328,000, or 32.0%, from 2015 to 2016 primarily due to our hiring of tax consultants to evaluate certain tax positions and our change of auditors.

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

	2017	**2016**	**2015**
Rent	2.2 %	2.4 %	3.3 %
Interest	6.0 %	5.9 %	5.1 %
Total occupancy cost	8.3 %	8.3 %	8.5 %

Depreciation and amortization decreased by $408,000, or 5.6%, from 2016 to 2017 mainly due to the cessation of depreciation on properties held for sale; and increased by $283,000, or 4.0%, from 2015 to 2016 mainly due to an increase in the number of clubs we own. Refer to Note 3 to our consolidated financial statements for the impact of the revision of prior year financial statements.

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

	Years Ended September 30,			Percentage of Revenues		
	2017	2016	2015	2017	2016	2015
Impairment of assets	$7,639	$3,492	$1,705	5.3 %	2.6 %	1.3 %
Settlement of lawsuits	317	1,881	11,684	0.2 %	1.4 %	8.6 %
Loss (gain) on sale of assets	(542)	388	808	-0.4%	0.3 %	0.6 %
Gain on settlement of patron tax	(102)	-	(8,167)	-0.1%	0.0 %	-6.0%
Total other charges, net	$7,312	$5,761	$6,030	5.0 %	4.3 %	4.5 %

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

During the year ended September 30, 2015, we recorded an impairment of $1.7 million ($1.4 million in the first quarter and $347,000 in the fourth quarter) for the indefinite-lived intangible assets at two clubs that were closed. During the fourth quarter of 2016, we recorded an impairment of $3.5 million, of which $2.1 million was for indefinite-lived intangible assets of one club and $1.4 million was for one property held for sale. During the year ended September 30, 2017, we recorded aggregate impairment charges of $7.6 million ($1.4 million in the third quarter and $6.2 million in the fourth quarter) for the goodwill of four club locations ($4.7 million), including one that we have put up for sale during the fiscal year; for property and equipment of one club ($385,000); for SOB license of two club locations ($1.4 million), and for our remaining investment in Drink Robust ($1.2 million). See Note 16 to our consolidated financial statements for further discussion.

Settlement of lawsuits in 2015 consists principally of settlement of suits relating to the New York based federal wage and hour class and collective action, as explained in Note 11 to our consolidated financial statements.

In 2015, the Company reached a settlement with the State of Texas over the payment of the state's Patron Tax on adult club customers. We recorded the difference between the present value of the $10.0 million settlement amount and the previously accrued tax amount as a gain in the amount of $8.2 million. See Note 11 to our consolidated financial statements for details of the gain on settlement of patron tax in 2015.

30

Income from Operations

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

	2017	2016	2015
Nightclubs	$35,138	$33,211	$30,428
Bombshells	3,084	1,152	1,638
Other	(522)	(2,650)	(1,921)
General corporate	(14,561)	(11,020)	(9,418)
	$23,139	$20,693	$20,727

Our operating margin (total income from operations divided by total revenues) was 16.0% in 2017, 15.3% in 2016 and 15.3% in 2015. Nightclubs operating margin was 28.2%, 29.1% and 26.3% in 2017, 2016 and 2015, respectively, primarily due to the closure of underperforming units, the leverage on increasing same-store sales of fixed expenses, and impairment of assets of $6.5 million, $2.1 million and $1.7 million for 2017, 2016 and 2015, respectively. Bombshells operating margin was 16.4%, 6.2% and 9.3% in 2017, 2016 and 2015, respectively, mainly due to increasing sales partially offset by increasing depreciation expense from higher unit count and the loss on sale of assets in 2016 caused by the closure of one underperforming unit.

Excluding the impact of settlement of lawsuits, impairment of assets, gain on patron tax settlement and gain on sale of assets, operating margin for the Nightclub segment would have been 33.1%, 32.3% and 30.9% for 2017, 2016 and 2015, respectively. Excluding the impact of loss on sale of assets, which caused fiscal 2016 and 2015 operating margin to be low, Bombshells segment operating margin would have been 16.4%, 13.5% and 13.9% for 2017, 2016 and 2015, respectively.

Non-Operating Items

Interest expense decreased in 2015 due to the significant paydown and refinance of high-interest debt during the last two years. We are now able to finance property acquisition with bank debt which is at significantly lower rates than the debt we previously had. We added more debt in 2017 and 2016 to acquire certain properties, which in turn increased our interest expense and also decreased rent expense.

Income Taxes

Income tax expense increased by $4.0 million from 2016 to 2017, and decreased by $2.8 million from 2015 to 2016. Our effective income tax rate was 43.4%, 18.5% and 36.5% during fiscal 2017, 2016 and 2015, respectively. The difference in our annual effective income tax rate was primarily due to the following:

	2017	2016	2015
Computed expected income tax expense	34.0%	34.0 %	34.0%
State income taxes, net of federal benefit	2.0 %	5.7 %	1.6 %
Transfer of deferred tax liabilities to sold subsidiaries	0.0 %	-6.5 %	0.0 %
Permanent differences	0.7 %	-0.8 %	0.9 %
Change in deferred tax liability rate	9.1 %	0.0 %	0.0 %
Reserve for uncertain tax position	2.8 %	1.9 %	0.0 %
Tax credits	-3.9 %	-15.7%	0.0 %
Other	-1.3 %	0.0 %	0.0 %
Total income tax expense	43.4%	18.5 %	36.5%

During fiscal year 2017, due to higher income before tax, our income tax rate has increased to 37%, of which has impacted the fourth quarter with the change in rate from 35% in the first nine months of the year and in prior years. A full year impact in the change in rate of our deferred tax liability has also been recognized in the fourth quarter. The change in deferred tax liability rate for 2017 is due to the 1% increase in our effective tax rate from the increase in the federal rate and also an increase in the states rate. This amount results from increasing by 2% the rate applied to our entire deferred tax liabilities at the beginning of the year. The reserve for uncertain tax positions results from an audit of the returns of one of the states in which we operate. As a result of the items discussed above which affected the fiscal year, the fourth quarter effective tax rate rose to 99.6% expense on a pre-tax loss.

During fiscal year 2016, we recognized a $2.0 million tax benefit representing the net amount to be realized from fiscal 2016 and from amending certain prior year federal tax returns to take available FICA tip tax credits, which were not taken in prior years.

Refer to Note 3 to our consolidated financial statements for the impact of the revision of prior year financial statements.

Non-GAAP Financial Measures

In addition to our financial information presented in accordance with GAAP, management uses certain non-GAAP financial measures, within the meaning of the SEC Regulation G, to clarify and enhance understanding of past performance and prospects for the future. Generally, a non-GAAP financial measure is a numerical measure of a company’s operating performance, financial position or cash flows that excludes or includes amounts that are included in or excluded from the most directly comparable measure calculated and presented in accordance with GAAP. We monitor non-GAAP financial measures because it describes the operating performance of the Company and helps management and investors gauge our ability to generate cash flow, excluding (or including) some items that management believes are not representative of the ongoing business operations of the Company, but are included in (or excluded from) the most directly comparable measures calculated and presented in accordance with GAAP. Relative to each of the non-GAAP financial measures, we further set forth our rationale as follows:

Non-GAAP Operating Income and Non-GAAP Operating Margin. We exclude from non-GAAP operating income and non-GAAP operating margin amortization of intangibles, gain on settlement of patron tax case, gains or losses on sale of assets, impairment of assets, stock-based compensation, and settlement of lawsuits. We believe that excluding these items assists investors in evaluating period-over-period changes in our operating income and operating margin without the impact of items that are not a result of our day-to-day business and operations.

Non-GAAP Net Income and Non-GAAP Net Income per Diluted Share. We exclude from non-GAAP net income and non-GAAP net income per diluted share amortization of intangibles, gain on settlement of patron tax case, income tax expense, impairment charges, gain on acquisition of controlling interest in subsidiary, gains or losses on sale of assets, stock-based compensation, and settlement of lawsuits, and include the non-GAAP provision for current and deferred income taxes, calculated as the tax effect at 37%, 35% and 35% in 2017, 2016 and 2015, respectively, effective tax rate of the pre-tax non-GAAP income before taxes, because we believe that excluding and including such items help management and investors better understand our operating activities.

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

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

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

	For the Year Ended September 30,		
	2017	2016	2015
Reconciliation of GAAP net income to Adjusted EBITDA			
Net income attributable to RCIHH common shareholders	$8,259	$11,218	$9,214
Income tax expense	6,359	2,373	5,111
Interest expense, net	8,498	7,851	6,954
Settlement of lawsuits	317	1,881	11,684
Gain on settlement of patron tax case	(102)	-	(8,167)
Impairment of assets	7,639	3,492	1,705
Loss (gain) on sale of assets	(542)	388	808
Depreciation and amortization	6,920	7,328	7,045
Gain on acquisition of controlling interest in subsidiary	-	-	(229)
Adjusted EBITDA	$37,348	$34,531	$34,125
Reconciliation of GAAP net income to non-GAAP net income			
Net income attributable to RCIHH common shareholders	$8,259	$11,218	$9,214
Amortization of intangibles	217	752	737
Stock-based compensation	-	360	480
Settlement of lawsuits	317	1,881	11,684
Gain on settlement of patron tax case	(102)	-	(8,167)
Impairment of assets	7,639	3,492	1,705
Income tax expense	6,359	2,373	5,111
Loss (gain) on sale of assets	(542)	388	808
Gain on acquisition of controlling interest in subsidiary	-	-	(229)
Non-GAAP provision for income taxes			
Current	(6,218)	(4,482)	(6,094)
Deferred	(1,976)	(2,680)	(1,376)
Non-GAAP net income	$13,953	$13,302	$13,873

	For the Year Ended September 30,		
	2017	2016	2015
Reconciliation of GAAP diluted net income per share to non-GAAP diluted net income per share			
Fully diluted shares	9,743	10,229	10,406
GAAP diluted net income per share	$0.85	$1.11	$0.89
Amortization of intangibles	0.02	0.07	0.07
Stock-based compensation	-	0.04	0.05
Settlement of lawsuits	0.03	0.18	1.12
Gain on settlement of patron tax case	(0.01)	-	(0.78)
Impairment of assets	0.78	0.34	0.16
Income tax expense	0.65	0.23	0.49
Loss (gain) on sale of assets	(0.06)	0.04	0.08
Gain on acquisition of controlling interest in subsidiary	-	-	(0.02)
Non-GAAP provision for income taxes			
Current	(0.64)	(0.43)	(0.59)
Deferred	(0.20)	(0.26)	(0.13)
Non-GAAP diluted net income per share	$1.43	$1.32	$1.34
Reconciliation of GAAP operating income to non-GAAP operating income			
Income from operations	$23,169	$20,693	$20,727
Amortization of intangibles	217	752	737
Stock-based compensation	-	360	480
Settlement of lawsuits	317	1,881	11,684
Gain on settlement of patron tax case	(102)	-	(8,167)
Impairment of assets	7,639	3,492	1,705
Loss (gain) on sale of assets	(542)	388	808
Non-GAAP operating income	$30,668	$27,566	$27,974
Reconciliation of GAAP operating margin to non-GAAP operating margin			
GAAP operating margin	16.0 %	15.3 %	15.3 %
Amortization of intangibles	0.1 %	0.6 %	0.5 %
Stock-based compensation	0.0 %	0.3 %	0.4 %
Settlement of lawsuits	0.2 %	1.4 %	8.6 %
Gain on settlement of patron tax case	-0.1 %	0.0 %	-6.0 %
Impairment of assets	5.3 %	2.6 %	1.3 %
Loss (gain) on sale of assets	-0.4 %	0.3 %	0.6 %
Non-GAAP operating margin	21.2 %	20.4 %	20.7 %

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

35

The adjustments to reconcile net income attributable to RCIHH common shareholders to non-GAAP net income exclude the impact of adjustments related to noncontrolling interests, which is immaterial. In the calculation of non-GAAP diluted net income per share, we take into consideration the adjustment to net income from assumed conversion of debentures (see Note 2 to the consolidated financial statements).

LIQUIDITY AND CAPITAL RESOURCES

We believe our ability to generate cash from operating activities is one of our fundamental financial strengths. The near-term outlook for our business remains strong, and we expect to generate substantial cash flows from operations in fiscal 2018. As a result of our expected cash flows from operations, we have significant flexibility to meet our financial commitments. The Company has not recently raised capital through the issuance of equity securities. Instead, we use debt financing to lower our overall cost of capital and increase our return on stockholders' equity. We have a history of borrowing funds in private transactions and from sellers in acquisition transactions and continue to have the ability to borrow funds at reasonable interest rates in that manner. We also have historically utilized these cash flows to invest in property and equipment, adult nightclubs and restaurants/sports bars.

As of September 30, 2017, we had negative working capital of $10.6 million (excluding the impact of assets held for sale amounting to $5.8 million) compared to negative working capital of $5.3 million as of September 30, 2016 (excluding the impact of assets held for sale amounting to $7.7 million). The decrease in working capital is principally due to the following items:

Operating cash flow for the year;

Increase in current portion of long-term debt; and

Partially offset by a net increase in current assets, excluding cash, mainly from prepaid income taxes and insurance.

We believe that our current sources of liquidity and capital will be sufficient to finance our continued operations and growth plans not only within the next 12 months, but for the next 18 to 24 months. Refer to sections on Debt Financing and Contractual Obligations and Commitments below for a discussion of long-term liquidity and capital resources.

Cash Flows from Operating Activities

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

	Year Ended September 30,		
	2017	2016	2015
Net income	$8,282	$10,469	$8,891
Depreciation and amortization	6,920	7,328	7,045
Deferred tax expense	2,273	1,143	3,882
Stock-based compensation expense	-	360	480
Gain on settlement of patron tax	(102)	-	(8,167)
Impairment of assets	7,639	3,492	1,705
Net change in operating assets and liabilities	(3,645)	(503)	1,951
Other	(273)	742	577
	$21,094	$23,031	$16,364

Net cash flows from operating activities decreased from 2016 to 2017 due to a decrease in working capital caused by year-end vendor payments, higher income taxes and higher interest expense paid in 2017; while net cash flows from operating activities increased from 2015 to 2016 due to lower income taxes paid and higher pre-tax income partially offset by higher interest expense paid in 2016.

Cash Flows from Investing Activities

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

	Year Ended September 30,		
	2017	2016	2015
Proceeds from sale of property	$2,145	$3,427	$-
Proceeds from notes receivable and sale of marketable securities	107	621	-
Additions to property and equipment	(11,249)	(28,148)	(19,259)
Additions of businesses, net of cash acquired	(9,527)	-	(2,328)
	$(18,524)	$(24,100)	$(21,587)

We opened five new units in 2017 (including two acquired and one reconcepted from a Bombshells to a club); reconcepted one club and acquired one club in 2016; and opened two clubs (including one acquired) in 2015. We also constructed and moved to a new corporate office in 2016.

Following is a reconciliation of our additions to property and equipment for the years ended September 30, 2017, 2016 and 2015 (in thousands):

	Year Ended September 30,		
	2017	2016	2015
Acquisition of real estate	$-	$22,174	$23,843
Capital expenditures funded by debt	-	-	(7,978)
New capital expenditures in new clubs and corporate building	9,436	3,456	1,919
Maintenance capital expenditures	1,813	2,518	1,475
Total capital expenditures in consolidated statements of cash flows	$11,249	$28,148	$19,259

Cash Flows from Financing Activities

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

	Year Ended September 30,		
	2017	2016	2015
Proceeds from long-term debt	$12,399	$32,049	$18,283
Payments on long-term debt	(13,080)	(19,159)	(12,579)
Payment of dividends	(1,170)	(862)	-
Purchase of treasury stock	(1,099)	(7,311)	(2,296)
Exercise of stock options and warrants	-	500	87
Payment of loan origination costs	(735)	(624)	-
Debt prepayment penalty	(75)	-	-
Distribution of noncontrolling interests	(215)	(217)	(216)
	$(3,975)	$4,376	$3,279

We purchased treasury stock representing 89,685 shares, 747,081 shares and 225,280 shares in 2017, 2016 and 2015, respectively. During the second quarter of 2016, we started paying quarterly dividends in the amount of $0.03 per share. See Note 8 to our consolidated financial statements for a detailed discussion of our debt obligations and Note 20 related to the refinancing of several of our real estate notes payable. We expect freed up liquidity from lower interest payments and the elimination of near-term balloon payments.

In summary, the following table presents our cash flows from operating, investing, and financing activities (in thousands):

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

	Year Ended September 30,		
	2017	2016	2015
Operating activities	$21,094	$23,031	$16,364
Investing activities	(18,524)	(24,100)	(21,587)
Financing activities	(3,975)	4,376	3,279
Net increase (decrease) in cash	$(1,405)	$3,307	$(1,944)

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

Non-GAAP Cash Flow Measure

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

	2017	2016	2015
Net cash provided by operating activities	$21,094	$23,031	$16,364
Less: Maintenance capital expenditures	1,813	2,518	1,475
Free cash flow	$19,281	$20,513	$14,889

Debt Financing

See Note 8 to our consolidated financial statements for detail regarding our long-term debt activity and Note 20 discussing the refinancing of our long-term debt.

Contractual Obligations and Commitments

We have long-term contractual obligations primarily in the form of debt obligations and operating leases. The following table (in thousands) summarizes our contractual obligations and their aggregate maturities as well as future minimum rent payments. Future interest payments related to variable interest rate debt were estimated using the interest rate in effect at September 30, 2017.

	Payments Due by Period						
	Total	2018	2019	2020	2021	2022	Thereafter
Long-term debt – regular	$61,788	$9,512	$9,653	$8,270	$6,116	$4,923	$ 23,314
Long-term debt – balloon	63,161	7,928	2,370	24,816	5,285	8,317	14,445
Interest payments	39,099	8,626	7,509	6,075	4,297	2,652	9,940
Operating leases	38,696	2,967	2,797	2,841	2,830	2,784	24,477
Uncertain tax positions(a)(b)	-	-	-	-	-	-	-

(a) We have $865,000 of uncertain tax positions recorded in accrued liabilities. It is expected that these assessments will be settled within the next twelve months. See Note 9 to our consolidated financial statements.

(b) On December 22, 2017, the Tax Cuts and Jobs Act was enacted into law (the “Act”). The Act provides, among others, the reduction of the statutory corporate income tax rate from 35% to 21% effective January 1, 2018.

On December 14, 2017, the Company entered into a loan agreement (“New Loan”) with a bank for $81.2 million. The New Loan fully refinances 20 of the Company’s notes payable and partially pays down 1 note payable (collectively, “Repaid Notes”) with interest rates ranging from 5% to 12% covering 43 parcels of real properties the Company previously acquired (“Properties”). The New Loan consists of three promissory notes:

i) The first note amounts to $62.5 million with a term of 10 years at a 5.75% fixed interest rate for the first five years, then repriced one time at the then current U.S. Treasury rate plus 3.5%, with a floor rate of 5.75%, and payable in monthly installments of $442,058, based upon a 20-year amortization period, with the balance payable at maturity;

ii) The second note amounts to $10.6 million with a term of 10 years at a 5.45% fixed interest rate until July 2020, after which to be repriced at a fixed interest rate of 5.75% until the fifth anniversary of this note, and then to be repriced again at the then interest rate of the first note. This note is payable $78,098 monthly for principal and interest until July 2020, based upon a 20-year amortization period, after which the monthly payment for principal and interest is adjusted accordingly based on the repricing, with the balance payable at maturity; and

iii) The third note amounts to $8.1 million with a term of 10 years at a 5.95% fixed interest rate until August 2021, after which to be repriced at 5.75% until the fifth anniversary of this note, and then to be repriced again at the then interest of the first note. This note is payable $100,062 monthly for principal and interest until August 2021, based upon a 20-year amortization period, after which the monthly payment for principal and interest is adjusted accordingly based on the repricing, with the balance payable at maturity.

In addition to the monthly principal and interest payments as provided above, the Company will pay monthly installments of principal of $250,000, applied to the first note, until such time as the loan-to-value ratio of the Properties, based upon reduced principal balance of the New Loan and the then current value of the Properties, is not greater than 65%. The New Loan has eliminated balloon payments of the Repaid Notes worth $2.9 million originally scheduled in fiscal 2018, $19.4 million originally scheduled in fiscal 2020 and $5.3 million originally scheduled in fiscal 2021.

In connection with the Repaid Notes, we wrote off $279,000 of unamortized debt issuance costs to interest expense. Prior to September 30, 2017, the Company paid a portion of debt issuance costs amounting to $612,500, which was included in other assets until the closing of the transaction. At closing, the Company paid an additional $764,000 in debt issuance costs, which together with the $612,500 prepayment will be amortized for the term of the loan using the effective interest rate method.

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

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

	2017	**Increase (Decrease)**	**2016**	**Increase (Decrease)**	**2015**
Sales of alcoholic beverages	$60,439	5.6 %	$57,216	2.5 %	$55,829
Sales of food and merchandise	18,256	2.0 %	17,900	-4.3 %	18,713
Service revenues	58,132	13.4 %	51,276	-3.3 %	53,014
Other	8,069	-4.7 %	8,468	7.3 %	7,893
Total revenues	$144,896	7.4 %	$134,860	-0.4 %	$135,449
Net cash provided by operating activities	$21,094	-8.4 %	$23,031	40.7 %	$16,364
Adjusted EBITDA*	$37,348	8.2 %	$34,531	1.2 %	$34,125
Long-term debt	$124,352	17.4 %	$105,886	12.2 %	$94,349

* See definition and calculation of Adjusted EBITDA under the Non-GAAP Financial Measures subsection of Results of Operations above.

We have not established financing other than the notes payable, including the New Loan in Note 20, and our existing line of credit facility discussed in Note 8 to the consolidated financial statements. There can be no assurance that we will be able to obtain additional financing on reasonable terms in the future, if at all, should the need arise.

Share Repurchase

As part of our capital allocation strategy, we buy back shares in the open market or through negotiated purchases, as authorized by our Board of Directors. During fiscal years 2017, 2016 and 2015, we paid for treasury stock amounting to $1.1 million, $7.3 million and $2.3 million representing 89,685 shares, 747,081 shares and 225,280 shares, respectively. We have $3.1 million remaining to purchase additional shares as of September 30, 2017.

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

IMPACT OF INFLATION

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

SEASONALITY

Our nightclub operations are affected by seasonal factors. Historically, we have experienced reduced revenues from April through September (our fiscal third and fourth quarters) with the strongest operating results occurring during October through March (our fiscal first and second quarters).

GROWTH STRATEGY

We believe that our nightclub operations can continue to grow organically and through careful entry into markets and demographic segments with high growth potential. Our growth strategy involves the following: (i) to acquire existing units in locations that are consistent with our growth and income targets and which appear receptive to the upscale club formula we have developed; (ii) to open new units after market analysis; (iii) to franchise our Bombshells brand; (iv) to form joint ventures or partnerships to reduce start-up and operating costs, with us contributing equity in the form of our brand name and management expertise; (v) to develop new club concepts that are consistent with our management and marketing skills; (vi) to develop and open our restaurant concepts as our capital and manpower allow; and (vii) to control the real estate in connection with club operations, although some units may be in leased premises.

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

During fiscal 2015, we acquired 51% of Drink Robust for $3.6 million. Prior to fiscal 2015, we owned 15% of Drink Robust for a $750,000 investment. In fiscal 2016, we sold 31% of our 51% interest in Robust, and in fiscal 2017, we fully impaired the remaining 20%. We also acquired an adult nightclub in Austin, Texas for $6.8 million, including the building in which it operates. We also acquired another adult nightclub in Minneapolis, Minnesota for $8.5 million, including the building in which it operates.

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

During fiscal 2017, we acquired two clubs, one in Florida (Scarlett's Miami) and another in Illinois (Hollywood Showclub) and certain adjacent real estate for an aggregate purchase price of $30.2 million. See Note 14 to the consolidated financial statements for details of the transactions. We subsequently relaunched Hollywood Showclub as Scarlett's St. Louis, and opened a club (Hollywood Hunt Club) on the real estate acquired in Illinois.

We plan to open at least two Bombshells in fiscal 2018.

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The items in our financial statements subject to market risk are debt instruments with variable interest rates, aggregating $4.3 million at September 30, 2017. The note bears interest at 2% above prime with a floor of 5%. If the prime rate were to rise, the effect on our annual statement of income would be $43,000, before taxes, for each 1% rise above a prime rate of 3.5%.

Item 8. Financial Statements and Supplementary Data.

The information required by this Item begins on page 43.

RCI HOSPITALITY HOLDINGS, INC.

CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

RCI Hospitality Holdings, Inc.

Houston, Texas

We have audited the accompanying consolidated balance sheet of RCI Hospitality Holdings, Inc. as of September 30, 2017 and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RCI Hospitality Holdings, Inc. at September 30, 2017, and the results of its operations and its cash flows the year then ended**,** in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method for testing goodwill for impairment for its fiscal 2017 annual impairment test as of September 30, 2017 due to the adoption of Accounting Standards Update No. 2017-04, "*Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.*"

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), RCI Hospitality Holdings, Inc.'s internal control over financial reporting as of September 30, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 14, 2018 expressed an adverse opinion thereon.

/s/ BDO USA, LLP

Cleveland, Ohio

February 14, 2018

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

RCI Hospitality Holdings, Inc.

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

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

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

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

RCI HOSPITALITY HOLDINGS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	September 30,	
	2017	2016
ASSETS		
Current assets		
Cash and cash equivalents	$9,922	$11,327
Accounts receivable, net	3,187	4,365
Inventories	2,149	2,019
Prepaid insurance	3,826	2,897
Other current assets	1,399	1,108
Assets held for sale	5,759	7,671
Total current assets	26,242	29,387
Property and equipment, net	148,410	141,073
Notes receivable	4,993	4,800
Goodwill	43,866	45,847
Intangibles, net	74,424	52,766
Other assets	1,949	2,188
Total assets	$299,884	$276,061
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$2,147	$1,701
Accrued liabilities	11,524	15,386
Current portion of long-term debt	17,440	9,950
Total current liabilities	31,111	27,037
Deferred tax liability, net	25,541	23,266
Long-term debt	106,912	95,936
Other long-term liabilities	1,095	483
Total liabilities	164,659	146,722
Commitments and contingencies (Note 11)		
Stockholders' equity		
Preferred stock, $0.10 par value per share; 1,000 shares authorized; none issued and outstanding	-	-
Common stock, $0.01 par value per share; 20,000 shares authorized; 9,719 and 9,808 shares issued and outstanding as of September 30, 2017 and 2016, respectively	97	97
Additional paid-in capital	63,453	64,552
Retained earnings	69,195	62,106
Total RCIHH stockholders' equity	132,745	126,755

Noncontrolling interests	2,480	2,584
Total stockholders' equity	135,225	129,339
Total liabilities and stockholders' equity	$299,884	$276,061

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

	Years Ended September 30,		
	2017	2016	2015
Revenues			
Sales of alcoholic beverages	$60,439	$57,216	$55,829
Sales of food and merchandise	18,256	17,900	18,713
Service revenues	58,132	51,276	53,014
Other	8,069	8,468	7,893
Total revenues	144,896	134,860	135,449
Operating expenses			
Cost of goods sold			
Alcoholic beverages sold	13,114	12,624	12,036
Food and merchandise sold	7,398	6,810	7,467
Service and other	209	1,112	814
Cost of goods sold (exclusive of items shown separately below)	20,721	20,546	20,317
Salaries and wages	40,029	37,457	37,732
Selling, general and administrative	46,775	43,075	43,598
Depreciation and amortization	6,920	7,328	7,045
Other charges, net	7,312	5,761	6,030
Total operating expenses	121,757	114,167	114,722
Income from operations	23,139	20,693	20,727
Other income (expenses)			
Interest expense	(8,764)	(7,982)	(6,969)
Interest income	266	131	15
Non-operating gains	-	-	229
Income before income taxes	14,641	12,842	14,002
Income taxes	6,359	2,373	5,111
Net income	8,282	10,469	8,891
Net loss (income) attributable to noncontrolling interests	(23)	749	323
Net income attributable to RCIHH common shareholders	$8,259	$11,218	$9,214
Earnings per share attributable to RCIHH common shareholders			
Basic	$0.85	$1.13	$0.89
Diluted	$0.85	$1.11	$0.89
Weighted average number of common shares outstanding			
Basic	9,731	9,941	10,359
Diluted	9,743	10,229	10,406

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Years Ended September 30,		
	2017	2016	2015
Net income	$8,282	$10,469	$8,891
Amount reclassified from accumulated other comprehensive income	-	(109)	-
Other comprehensive income:			
Unrealized holding gain on securities available for sale	-	-	18
Comprehensive income	8,282	10,360	8,909
Comprehensive loss (income) attributable to noncontrolling interests	(23)	749	323
Comprehensive income attributable to RCI Hospitality Holdings, Inc.	$8,259	$11,109	$9,232

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended September 30, 2017, 2016 and 2015

(in thousands)

	Common Stock		Additional		Accumulated Other	Treasury Stock			Total
	Number of Shares	Amount	Paid-In Capital	Retained Earnings	Comprehensive Income	Number of Shares	Amount	Noncontrolling Interests	Stockholders' Equity
Balance at September 30, 2014	10,067	$ 101	$ 66,727	$ 42,536	$ 91	-	$ -	$ 3,010	$ 112,465
Purchase of treasury shares	-	-	-	-	-	(225)	(2,296)	-	(2,296)
Canceled treasury shares	(225)	(2)	(2,294)	-	-	225	2,296	-	-
Stock options exercised	10	-	87	-	-	-	-	-	87
Common stock issued for acquisition	200	2	2,373	-	-	-	-	-	2,375
Common stock issued for debt and interest	233	2	2,356	-	-	-	-	-	2,358
Stock-based compensation	-	-	480	-	-	-	-	-	480
Payments to noncontrolling interests	-	-	-	-	-	-	-	(216)	(216)
Noncontrolling interests at acquisition of business	-	-	-	-	-	-	-	3,392	3,392
Change in marketable securities	-	-	-	-	18	-	-	-	18
Net income (loss)	-	-	-	9,214	-	-	-	(323)	8,891
Balance at September 30, 2015	10,285	$ 103	$ 69,729	$ 51,750	$ 109	-	$ -	$ 5,863	$ 127,554
Purchase of treasury shares	-	-	-	-	-	(747)	(7,311)	-	(7,311)
Canceled treasury shares	(747)	(8)	(7,303)	-	-	747	7,311	-	-
Vesting of restricted stock	96	1	(1)	-	-	-	-	-	-
	125	1	1,267	-	-	-	-	-	1,268

Common stock issued for debt and interest									
Warrants exercised	49	-	500	-	-	-	-	-	500
Stock-based compensation	-	-	360	-	-	-	-	-	360
Payment of dividends	-	-	-	(862)	-	-	-	-	(862)
Payments to noncontrolling interests	-	-	-	-	-	-	-	(217)	(217)
Divestiture in Drink Robust	-	-	-	-	-	-	-	(2,313)	(2,313)
Change in marketable securities	-	-	-	-	(109)	-	-	-	(109)
Net income (loss)	-	-	-	11,218	-	-	-	(749)	10,469
Balance at September 30, 2016	9,808	$ 97	$ 64,552	$ 62,106	$ -	-	$ -	$ 2,584	$ 129,339
Purchase of treasury shares	-	-	-	-	-	(89)	(1,099)	-	(1,099)
Canceled treasury shares	(89)	-	(1,099)	-	-	89	1,099	-	-
Payment of dividends				(1,170)					(1,170)
Payments to noncontrolling interests								(215)	(215)
Divestiture in Drink Robust								88	88
Net income				8,259				23	8,282
Balance at September 30, 2017	9,719	$ 97	$ 63,453	$ 69,195	$ -	-	$ -	$ 2,480	$ 135,225

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Years Ended September 30,		
	2017	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$8,282	$10,469	$8,891
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	6,920	7,328	7,045
Deferred tax expense	2,273	1,143	3,882
Loss (gain) on sale of assets	(838)	388	808
Impairment of assets	7,639	3,492	1,705
Amortization of debt issuance costs, note discount and beneficial conversion	218	455	36
Gain on acquisition of controlling interest in subsidiary	-	-	(229)
Gain on settlement of patron tax	(102)	-	(8,167)
Gain on sale of marketable securities	-	(116)	-
Deferred rent expense (credit)	272	15	(38)
Stock-based compensation expense	-	360	480
Debt prepayment penalty	75	-	-
Changes in operating assets and liabilities:			
Accounts receivable	878	(3,986)	(339)
Inventories	(19)	(124)	54
Prepaid expenses and other assets	(1,526)	(18)	852
Accounts payable and accrued liabilities	(2,978)	3,625	1,384
Net cash provided by operating activities	21,094	23,031	16,364
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of assets	2,145	3,427	-
Proceeds from sale of marketable securities	-	621	-
Proceeds from notes receivable	107	-	-
Additions to property and equipment	(11,249)	(28,148)	(19,259)
Acquisition of businesses, net of cash acquired	(9,527)	-	(2,328)
Net cash used in investing activities	(18,524)	(24,100)	(21,587)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from long-term debt	12,399	32,049	18,283
Payments on long-term debt	(13,080)	(19,159)	(12,579)
Exercise of stock options and warrants	-	500	87
Purchase of treasury stock	(1,099)	(7,311)	(2,296)
Payment of dividends	(1,170)	(862)	-
Payment of loan origination costs	(735)	(624)	-
Debt prepayment penalty	(75)	-	-

Distribution to noncontrolling interests	(215)	(217)	(216)
Net cash provided by (used in) financing activities	(3,975)	4,376	3,279
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,405)	3,307	(1,944)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	11,327	8,020	9,964
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$9,922	$11,327	$8,020
CASH PAID DURING PERIOD FOR:			
Interest paid, net of amounts capitalized	$8,081	$7,719	$6,540
Income taxes	$4,185	$1,914	$3,776

Non-cash transactions:

	Years Ended September 30,		
	2017	2016	2015
Issue of shares of common stock for debt and interest			
Number of shares	-	125	233
Value of shares	$-	$1,268	$2,358
Debt incurred in connection with seller in connection with acquisition of businesses and property and equipment	$20,552	$-	$3,379
Notes receivable received as proceeds from sale of assets	$-	$4,800	$-
Accrued liabilities due settled with debt	$-	$-	$7,234
Unrealized gain on marketable securities	$-	$-	$18
Issue of shares of common stock for acquiring a business			
Number of shares	-	-	200
Value of shares	$-	$-	$2,375
Note payable reduction from sale proceeds of property	$1,500	$-	$-
Refinanced long-term debt	$8,000	$-	$-

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC.

Notes to Consolidated Financial Statements

1. Nature of Business

RCI Hospitality Holdings, Inc. (the "Company") is a holding company incorporated in Texas in 1994. Through its subsidiaries, the Company currently owns and operates establishments that offer live adult entertainment, restaurant, and/or bar operations. These establishments are located in Houston, Austin, San Antonio, Dallas, Fort Worth, Odessa, Lubbock, Longview, Tye, Edinburg, El Paso, Harlingen, Lubbock and Beaumont, Texas, as well as Minneapolis, Minnesota; Philadelphia, Pennsylvania; Charlotte, North Carolina; New York, New York; Pembroke Park and Miami Gardens, Florida; Phoenix, Arizona; Sulphur, Louisiana; and Washington Park, Illinois. The Company also owns and operates media businesses for adults. The Company's corporate offices are located in Houston, Texas.

2. Summary of Significant Accounting Policies

Basis of Accounting

The accounts are maintained and the consolidated financial statements have been prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries in which a controlling interest is owned. Intercompany accounts and transactions have been eliminated in consolidation.

Fiscal Year

Our fiscal year ends on September 30. References to years 2017, 2016 and 2015 are for fiscal years ended September 30, 2017, 2016 and 2015, respectively. Our fiscal quarters chronologically end on December 31, March 31, June 30 and September 30.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect certain reported amounts in the consolidated financial statements and accompanying notes. Estimates and assumptions are based on historical experience, forecasted future events and various other assumptions that we believe to be reasonable under the circumstances. Estimates and assumptions may vary under different circumstances and conditions. We evaluate our estimates and assumptions on an ongoing basis. We believe the accounting policies below are critical in the portrayal of our financial condition and results of operations.

Cash and Cash Equivalents

The Company considers as cash equivalents all highly liquid investments with a maturity of three months or less when purchased. The Company maintains deposits in several financial institutions, which may at times exceed amounts covered by insurance provided by the U.S. Federal Deposit Insurance Corporation ("FDIC"). The Company has not experienced any losses related to amounts in excess of FDIC limits.

RCI HOSPITALITY HOLDINGS, INC.

Notes to Consolidated Financial Statements

2. Summary of Significant Accounting Policies - continued

Accounts and Notes Receivable

Accounts receivable for club and restaurant operations are primarily comprised of credit card charges, which are generally converted to cash in two to five days after a purchase is made. The media division's accounts receivable are primarily comprised of receivables for advertising sales and Expo registration. Accounts receivable also include employee advances and other miscellaneous receivables. Long-term notes receivable include consideration from the sale of certain investment interest entities and real estate. The Company recognizes interest income on notes receivable based on the terms of the agreement and based upon management's evaluation that the notes receivable and interest income will be collected. The Company recognizes allowances for doubtful accounts or notes when, based on management judgment, circumstances indicate that accounts or notes receivable will not be collected.

Inventories

Inventories include alcoholic beverages, energy drinks, food, and Company merchandise. Inventories are carried at the lower of cost (on a first-in, first-out ("FIFO") basis), or market.

Property and Equipment

Property and equipment are stated at cost. Provisions for depreciation and amortization are made using straight-line rates over the estimated useful lives of the related assets, and the shorter of useful lives or terms of the applicable leases for leasehold improvements. Buildings have estimated useful lives ranging from 29 to 40 years. Furniture and equipment have estimated useful lives of 5 to 7 years, while leasehold improvements are depreciated at the shorter of the lease term or estimated useful life. Expenditures for major renewals and betterments that extend the useful lives are capitalized. Expenditures for normal maintenance and repairs are expensed as incurred. The cost of assets sold, retired or abandoned and the related accumulated depreciation are written off from the accounts and any gains or losses are charged or credited in the accompanying consolidated statement of income of the respective period. Interest expense during site construction from related debt is capitalized, amounting to $43,000 in fiscal 2017 and $59,000 in fiscal 2016.

See Note 3 in relation to revision of prior year financial statements.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets with indefinite lives are not amortized, but reviewed on an annual basis for impairment. Definite-lived intangible assets are amortized on a straight-line basis over their estimated lives.

The costs of purchasing transferable licenses through open markets are capitalized as indefinite-lived intangible assets. The costs of obtaining non-transferable licenses that are directly issued by local government agencies are expensed as incurred. Annual license renewal fees are expensed over their renewal term.

Goodwill and other intangible assets that have indefinite useful lives are tested annually for impairment during our fourth fiscal quarter, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value.

RCI HOSPITALITY HOLDINGS, INC.

Notes to Consolidated Financial Statements

2. Summary of Significant Accounting Policies - continued

For our goodwill impairment review, we first perform a qualitative assessment to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying value. This assessment is based on several factors, including industry and market conditions, overall financial performance, including an assessment of cash flows in comparison to actual and projected results of prior periods. If it is determined that it is more likely than not that the fair value of a reporting unit is less than its carrying value based on our qualitative analysis, we perform a Step 1 analysis to determine the fair value of the reporting unit. The fair value is determined using market-related valuation models, including earnings multiples, discounted cash flows, and comparable asset market values. As detailed in the "Impact of Recently Issued Accounting Standards" section of this Note, we adopted ASU 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, during Q4 of 2017, and accordingly, we recognize goodwill impairment in the amount that the carrying value of the reporting unit exceeds the fair value of the reporting unit, not to exceed the amount of goodwill allocated to the reporting unit, based on the results of our Step 1 analysis. For the year ended September 30, 2017, we identified four reporting units that were impaired and recognized a goodwill impairment loss totaling $4.7 million. See Note 16.

For indefinite-lived intangibles, specifically SOB licenses, we determine fair value by estimating the multiperiod excess earnings of the asset. For indefinite-lived tradename, we determine fair value by using the relief from royalty method. The fair value is then compared to the carrying value and an impairment charge is recognized by the amount by which the carrying amount exceeds the fair value of the asset. We recorded impairment charges for SOB licenses amounting to $1.4 million for 2017, $2.1 million for 2016 and $1.7 million for 2015, related to two clubs in 2017, one club in 2016 and two clubs in 2015. See Note 16

See related discussion of the early adoption of ASU 2017-04 at the end of Note 2.

Impairment of Long-Lived Assets

The Company reviews long-lived assets, such as property, plant, and equipment, and intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. These events or changes in circumstances include, but are not limited to, significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of the acquired assets or the strategy for the overall business, and significant negative industry or economic trends. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset group to the estimated undiscounted cash flows over the estimated remaining useful life of the asset group. If the asset group is not recoverable, the impairment loss is calculated as the excess of the carrying value over the fair value. We define our asset group as an operating club or restaurant location, which is also our reporting unit or the lowest level for which cash flows can be identified. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. For assets held for sale, we measure fair value using an estimation based on quoted prices for similar items in active or inactive markets (level 2) developed using observable data. The assets and liabilities of a disposal group classified as held for sale are presented separately in the appropriate asset and liability sections of the balance sheet. During the fourth quarter of fiscal 2017, the Company impaired one club for $385,000, and during the fourth quarter of fiscal 2016, the Company recognized a loss on disposal on one property held for sale in Fort Worth, Texas for $1.4 million. See Note 16.

Fair Value of Financial Instruments

The Company calculates the fair value of its assets and liabilities which qualify as financial instruments and includes this additional information in the notes to consolidated financial statements when the fair value is different than the carrying value of these financial instruments. The estimated fair value of accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to the relatively short maturity of these instruments. The carrying value of notes receivable and short and long-term debt also approximates fair value since these instruments bear market rates of interest. None of these instruments are held for trading purposes.

Comprehensive Income

Comprehensive income is the total of net income or loss and all other changes in net assets arising from non-owner sources, which are referred to as items of other comprehensive income. An analysis of changes in components of accumulated other comprehensive income is presented in the consolidated statements of comprehensive income.

RCI HOSPITALITY HOLDINGS, INC.

Notes to Consolidated Financial Statements

2. Summary of Significant Accounting Policies - continued

Revenue Recognition

The Company recognizes revenue from the sale of alcoholic beverages, food and merchandise, service and other revenues at the point-of-sale upon receipt of cash, check, or credit card charge, net of discounts and promotional allowances. Sales and liquor taxes collected from customers and remitted to governmental authorities are presented on a net basis in the accompanying consolidated statements of income.

Revenues from the sale of magazines and advertising content are recognized when the issue is published and shipped. Revenues and external expenses related to the Company's annual Expo convention are recognized upon the completion of the convention. Other rental revenues are recognized when earned.

Advertising and Marketing

Advertising and marketing expenses are primarily comprised of costs related to public advertisements and giveaways, which are used for promotional purposes. Advertising and marketing expenses are expensed as incurred and are included in selling, general and administrative expenses in the accompanying consolidated statements of income. See Note 4.

Income Taxes

The Company and its subsidiaries are subject to U.S. federal income tax and income taxes imposed in the state and local jurisdictions where we operate our businesses. Deferred income taxes are determined using the liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In addition, a valuation allowance is established to reduce any deferred tax asset for which it is determined that it is more likely than not that some portion of the deferred tax asset will not be realized.

RCI HOSPITALITY HOLDINGS, INC.

Notes to Consolidated Financial Statements

2. Summary of Significant Accounting Policies - continued

U.S. GAAP creates a single model to address accounting for uncertainty in tax positions by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. We recognize penalties related to unrecognized tax benefits as a component of selling, general and administrative expenses, and recognize interest accrued related to unrecognized tax benefits in interest expense.

See Note 3 in relation to revision of prior year financial statements.

Investments

Investments in companies in which the company has a 20% to 50% interest are accounted for using the equity method, which are carried at cost and adjusted for the Company's proportionate share of their undistributed earnings or losses. Investments in companies in which the Company owns less than a 20% interest, or where the Company does not exercise significant influence, are accounted for at cost and reviewed for any impairment. Cost and equity method investments are included in other assets in the Company's consolidated balance sheets. During the year ended September 30, 2013, the Company acquired approximately 12% of Drink Robust, Inc. ("Robust") for $600,000. This investment was increased to 15% during the year ended September 30, 2014, and to 51% in October 2014, at which time the subsidiary became part of the consolidated group. The Company sold 31% of this company on September 29, 2016, retaining 20% (see additional discussion in Note 14). Because the Company has no ability to direct the management of the investee company or exert significant influence, the investment is being accounted for at cost beginning on the date of sale. The carrying value of the cost-method investment in Robust was $1.2 million as of September 30, 2016. During the fourth quarter of fiscal 2017, we determined our investment in Drink Robust was impaired and recognized an other-than temporary impairment totaling $1.2 million which brought our carrying value of this investment to zero.

Earnings Per Common Share

Basic earnings per share includes no dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of the Company. Potential common stock shares consist of shares that may arise from outstanding dilutive common restricted stock, stock options and warrants (the number of which is computed using the "treasury stock method") and from outstanding convertible debentures (the number of which is computed using the "if converted method"). Diluted earnings per share ("EPS") considers the potential dilution that could occur if the Company's outstanding common restricted stock, stock options, warrants and convertible debentures were converted into common stock that then shared in the Company's earnings or losses (as adjusted for interest expense, that would no longer occur if the debentures were converted).

RCI HOSPITALITY HOLDINGS, INC.

Notes to Consolidated Financial Statements

2. Summary of Significant Accounting Policies - continued

Net earnings applicable to common stock and the weighted average number of shares used for basic and diluted earnings (loss) per share computations are summarized in the table that follows (in thousands, except per share data):

	For the Year Ended September 30,		
	2017	2016	2015
Basic earnings per share:			
Net income attributable to RCIHH shareholders	$8,259	$11,218	$9,214
Weighted average number of common shares outstanding - basic	9,731	9,941	10,359
Basic earnings per share	$0.85	$1.13	$0.89
Diluted earnings per share:			
Net income attributable to RCIHH shareholders	$8,259	$11,218	$9,214
Adjustment to net earnings from assumed conversion of debentures (1)	5	153	29
Adjusted net income attributable to RCIHH shareholders	8,264	11,371	9,243
Weighted average number of common shares outstanding - diluted:			
Weighted average number of common shares outstanding - basic	9,731	9,941	10,359
Effect of potentially dilutive restricted stock, warrants and options (2)	-	60	-
Effect of potentially dilutive convertible debentures (1)	12	228	47
Weighted average number of common shares outstanding - diluted	9,743	10,229	10,406
Diluted earnings per share	$0.85	$1.11	$0.89

*EPS may not foot due to rounding.

(1) Represents interest expense on dilutive convertible securities that would not occur if they were assumed converted.

(2) All outstanding warrants and options were considered for the EPS computation.

Additional shares for options, warrants and debentures amounting to zero, 72,400 and 353,400 for the year ended September 30, 2017, 2016 and 2015 were not considered since they would be antidilutive.

Convertible debentures (principal and accrued interest) outstanding at September 30, 2017, 2016 and 2015 totaling $0, $0.5 million and $4.6 million, respectively, were convertible into common stock at prices ranging from $10.00 to $12.50 in each of fiscal year 2016 and 2015. Convertible debentures amounting to $0.9 million, $0.5 million and $0.5 million were dilutive in 2017, 2016 and 2015, respectively.

See Note 3 in relation to revision of prior year financial statements.

RCI HOSPITALITY HOLDINGS, INC.

Notes to Consolidated Financial Statements

2. Summary of Significant Accounting Policies - continued

Stock Options

At September 30, 2017 and 2016, the Company has no stock options outstanding. The Company recognizes all employee stock-based compensation as a cost in the consolidated financial statements. Equity-classified awards are measured at the grant date fair value of the award and recognized as expense over their requisite service period. The Company estimates grant date fair value using the Black-Scholes option-pricing model. The critical estimates are volatility, expected life and risk-free rate.

Legal and Other Contingencies

The Company records a liability when it is probable that a loss has been incurred and the amount is reasonably estimable. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In the opinion of management, there was not at least a reasonable possibility that we may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies for asserted legal and other claims. The Company recognizes legal fees and expenses, including those related to legal contingencies, as incurred.

Generally, the Company recognizes gain contingencies when they are realized or when all related contingencies have been resolved.

Fair Value Accounting

The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels.

U.S. GAAP establishes a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 – Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 – Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company classifies its marketable securities as available-for-sale, which are reported at fair value. Unrealized holding gains and losses, net of the related income tax effect, if any, on available-for-sale securities are excluded from income and are reported as accumulated other comprehensive income in stockholders' equity. Realized gains and losses from securities classified as available for-sale are included in comprehensive income. The Company measures the fair value of its marketable securities based on quoted prices for identical securities in active markets, or Level 1 inputs. Available-for-sale securities had zero balance as of September 30, 2017 and 2016.

RCI HOSPITALITY HOLDINGS, INC.

Notes to Consolidated Financial Statements

2. Summary of Significant Accounting Policies - continued

In accordance with U.S. GAAP, the Company reviews its marketable securities to determine whether a decline in fair value of a security below the cost basis is other than temporary. Should the decline be considered other than temporary, the Company writes down the cost basis of the security and include the loss in current earnings as opposed to an unrealized holding loss. No losses for other than temporary impairments in our marketable securities portfolio were recognized during the years ended September 30, 2017, 2016 and 2015.

Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities that are measured at fair value on a nonrecurring basis relate primarily to tangible property and equipment, goodwill and other intangible assets, which are remeasured when the derived fair value is below carrying value in the consolidated balance sheets. For these assets, the Company does not periodically adjust carrying value to fair value except in the event of impairment. If it is determined that impairment has occurred, the carrying value of the asset is reduced to fair value and the difference is included in other charges, net in the consolidated statements of income.

Assets and liabilities that are measured at fair value on a nonrecurring basis are as follows (in thousands):

		Fair Value at Reporting Date Using		
	September 30,	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs

Description	2017	(Level 1)	(Level 2)	(Level 3)
Goodwill	$ 4,572	$ -	$ -	$ 4,572
Property and equipment, net	4,678	-		