

RCI Hospitality Holdings, Inc. (RICK):

The Starbucks of Adult Entertainment



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A Superior Hospitality Company

Equity markets are valuing RCI Hospitality Holdings, Inc. (RICK) as if it were a run of the mill restaurant-bar company with a PE of 10x with a further 20% sin stock discount. The market is misvaluing RICK by a wide margin and ignoring the value the Company has been creating since it launched its capital allocation strategy in FY16 and improved systemwide nightclub operations.

RICK is not an ordinary restaurant-bar company. This is evidenced by one, simple financial metric. Its return on tangible assets (ROTA) is significantly greater than other publicly traded restaurant groups that have company-operated stores (as opposed to franchises). The ROTA for RICK and these restaurant groups largely reflects how much cash flow the dollar of real estate can generate since equipment and fixtures are relatively minimal for these businesses.

The table below shows the ROTA for ten well-known groups that operate their own stores. The average is 8.8% and ranges from a low of 4.1% for the reputable Cheesecake Factory to a high of 16.7% for Chipotle, considered one of the best restaurant groups in the US. RICK, on the other hand, has a far superior ROTA of 29.1%. On top of that, RICK owns its real estate which means RICK can benefit from asset price appreciation along with serving as a hedge against inflation. In fact, RICK has demonstrated its ability to benefit from such increased value with periodic bank refinancings of its real estate. This has facilitated growth with no need to raise new equity. The truth is RICK is both growing and returning capital to shareholders.

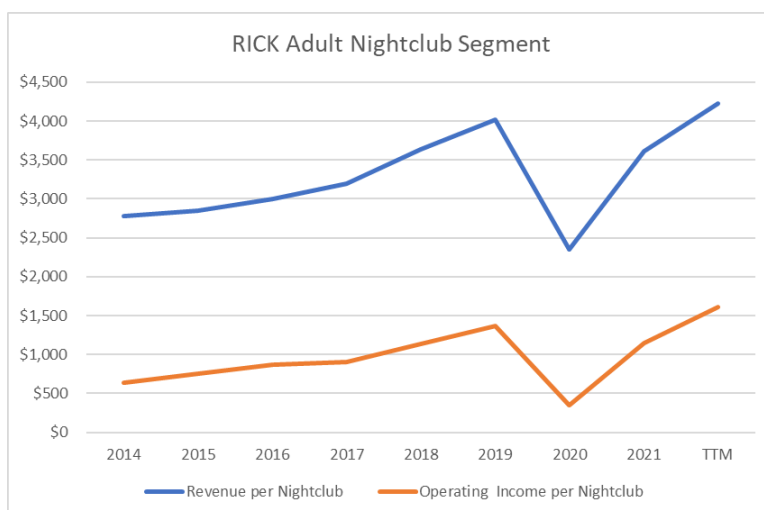
Name	Chipotle	Darden	Texas Roadhouse	Dave & Busters	Cheesecake Factory
Type	Company-operated	Company-operated	Company-operated	Company-operated	Company-operated
Property Financing	Leased	Leased	Leased	Leased	Leased
Earnings	\$900,000	\$953,000	\$245,000	\$150,000	\$95,000
Tangible Assets	\$5,401,869	\$8,678,000	\$1,985,574	\$2,031,415	\$2,325,924
Tangible Equity	\$1,010,732	\$740,200	\$617,875	(\$59,943)	(\$84,825)
Total Debt	\$3,624,353	\$4,656,800	\$756,929	\$1,726,452	\$1,662,937
Market Capitalization	\$45,000,000	\$15,343,000	\$5,848,000	\$2,057,000	\$1,614,000
Return on Tangible Assets	16.7%	11.0%	12.3%	7.4%	4.1%
Total Debt-to-Earnings	4.0x	4.9x	3.1x	11.5x	17.5x
P/E Ratio	50.0x	16.1x	23.9x	13.7x	17.0x

Name	Brinker	First Watch	RUTH's	ONE Group	Ark Restaurants
Type	Company-operated	Company-operated	50/50	Company-operated	Company-operated
Property Financing	Leased	Leased	Leased	Leased	Leased
Earnings	\$117,000	\$30,000	\$40,000	\$18,000	\$12,800
Tangible Assets	\$2,261,900	\$681,463	\$418,335	\$195,526	\$161,120
Tangible Equity	(\$490,600)	\$118,337	\$45,171	\$28,786	\$37,834
Total Debt	\$2,140,200	\$493,466	\$272,955	\$133,882	\$102,799
Market Capitalization	\$1,131,000	\$1,095,000	\$609,000	\$227,000	\$64,087
Return on Tangible Assets	5.2%	4.4%	9.6%	9.2%	7.9%
Total Debt-to-Earnings	18.3x	16.4x	6.8x	7.4x	8.0x
P/E Ratio	9.7x	36.5x	15.2x	12.6x	5.0x

Restaurant Groups Summary Statistics				
	Average	Median	Minimum	Maximum
Return on Tangible Assets	8.8%	10.3%	4.1%	16.7%
Total Debt-to-Earnings	9.8x	7.7x	3.1x	18.3x
P/E Ratio	20.0x	15.7x	5.0x	50.0x

Name	RICK
Type	Company-operated
Property Financing	Owned
Earnings	\$79,444
Tangible Assets	\$272,695
Tangible Equity	\$2,201
Total Debt	\$227,414
Market Capitalization	\$580,000
Return on Tangible Assets	29.1%
Total Debt-to-Earnings	2.9x
P/E Ratio	7.3x

The following graphs show the improvement in RICK's operations since 2016. The dip in 2020 was due to the temporary impact of Covid regulations on operations. RICK has improved operating metrics over the last eight years by focusing on creating exciting experiences and a fun environment at the best adult nightclubs in the USA while moving away from operating low quality strip clubs.



RICK & SBUX: More Similar than You Think

The more accurate hospitality industry comparison for RICK is Starbucks (Nasdaq: SBUX), which has a high ROTA of 19.4%, although still lower than RICK. Moreover, SBUX's business is significantly more analogous to RICK's on both a physical and emotional level.

At first glance, it would appear SBUX could not be more different than RICK. SBUX sells coffee and RICK owns and operates adult nightclubs. But upon further reflection, we will show RICK is similar to SBUX in several key dimensions. As everyone knows, SBUX is not just in the coffee business. It is in the business of providing an identity, lifestyle, and community to its customers. SBUX monetizes these services through coffee, drink, and food sales.

Now let's look at RICK. Through its subsidiaries, the company owns and operates 52 adult nightclubs around the US. Note that we did not say strip clubs. RICK's clubs are NOT dive bars where random strangers buy cheap beer and ogle women. Rather, RICK's clubs are entertainment destinations with clean facilities, great light and sound systems, and high-energy live entertainment.

Similar to SBUX, RICK provides an identity, lifestyle and community to its customers and entertainers. RICK monetizes this environment and experience through entrance fees, drink sales, bottle service, and service revenues. Like SBUX, RICK's value creation does not come from selling drinks per se. Instead, RICK creates value by selling an immersive experience and building communities that gather and interact at its adult nightclubs.

Saying RICK operates strip clubs is like saying SBUX sells gas station coffee.



Third Place

Starbucks provides a “third place” where consumers can go besides home and work. It is a “safe space” where customers can work, network, and socialize along with expressing their personalities. Ray Oldenburg is an American urban sociologist known for writing about the significance of informal public gathering places.¹ According to him, third places are real-life sites that host regular, voluntary, informal, and happily anticipated gatherings of individuals beyond the domains of home and work.² Similar to SBUX, RICK provides a “third place” outside the home and work. It is a “safe space” where (1) men can pay to relax and socialize with beautiful female entertainers, and (2) entertainers can earn money providing these services.

Emotional Triggers

Emotional triggers help SBUX attract and retain customers. Dr. B. J. Fogg is the Director of Persuasive Technology Lab at Stanford University and a pioneer in the field of behavior design.³ He believes “there are three ingredients required to initiate any and all behaviors: (1) the user must have sufficient motivation; (2) the user must have the ability to complete the desired action; and (3) a trigger must be present to activate the behavior.”⁴

As every coffee consumer knows, SBUX coffee has a strong, distinctive smell and flavor. You catch the fragrance the moment you enter a store. Moreover, for most people, coffee is a stimulant that makes you feel good. For SBUX customers, the following image (or even the thought of it) can trigger thoughts of the pleasant feelings you get from being at Starbucks.



¹ https://en.wikipedia.org/wiki/Ray_Oldenburg

² <https://www.pps.org/article/roldenburg>

³ <https://behavioraldesign.stanford.edu/>

⁴ <https://daringtolivefully.com/the-fogg-behavior-model>

Likewise, the following image (or thought) can trigger similarly pleasant feelings of being at one of RICK's clubs. Moreover, studies have shown that heterosexual men viewing images of attractive female faces have higher than normal levels of dopamine, the “feel-good” hormone that gives you a sense of pleasure.⁵



It is easy for SBUX and RICK customers to feel triggers throughout the day that may remind them of each company's respective brand and community. Driving or walking by a Starbucks on the way to work can motivate one to enter the store and buy a latte. Likewise, leaving work can motivate men to go to one of RICK's clubs and spend time with attractive women who are going to act friendly to, and interested, in them.

Customer Stickiness

Variable rewards are another key factor that SBUX uses to build valuable repeat experiences for customers. While drinks at Starbucks are appreciated for their consistency, the experience changes daily. The store can be busy or quiet, have new patrons, play new music, etc. This creates feelings of both comfort and a sense of anticipation. Likewise for RICK, a club is valued for its consistency, but the experience can vary with different DJs and music, lightshows, special events, and, most of all, entertainers.

⁵ <https://my.clevelandclinic.org/health/articles/22581-dopamine>

Nir Eyal is the author of the book, *Hooked: How to Build Habit-Forming Products*.⁶ He says variable rewards come in three forms: the Tribe, the Hunt, and the Self. Rewards of the Tribe are driven by connections with other people that make us feel accepted, attracted, important, and included. Rewards of the Hunt come from gaining resources that aid in survival. Rewards of the Self are fueled by a desire to gain a sense of competency.⁷ A visit to a RICK club benefits a client with feelings of acceptance in a group (Rewards of the Tribe) and confirmations of competence when speaking with attractive women (Rewards of the Self).

The benefits of return visits increase consumer mindshare, stickiness, and loyalty. All this translates into repeat business for SBUX and RICK. This is an extremely valuable asset for both companies. Yes, the thought of a steak can trigger intense feelings of hunger, but restaurants have a difficult time creating a community and “third place” of belonging. Whereas SBUX and RICK have both successfully created communities around their physical stores. How many times have you heard people complain about the ever-rising prices, yet continue to go to “my Starbucks.” RICK is similar. The company had to shutter all its clubs due to government regulations at the start of the COVID pandemic in March 2020. But as these restrictions lifted in each market, RICK’s customers returned. If that’s not stickiness, we don’t know what is.

⁶ <https://www.nirandfar.com/about-nir-eyal/>

⁷ <https://www.nirandfar.com/want-to-hook-your-users-drive-them-crazy/>

Starbucks Photos



RCI Club Photos



Valuation

With all this in common, however, RICK trades at a much lower multiple than SBUX, yet earns a better ROTA. If we value RICK the same as SBUX, we get a \$203 share price target versus RICK's current price of \$65. Okay, go ahead and knock off 20% for RICK being a sin stock if you want. You still get a valuation of \$162, 2.5 times RICK's current price. On the other hand, RICK owns its properties whereas SBUX leases its stores. RICK is also earlier in its growth story, has lower debt ratios, higher returns, and has yet to fully create national brands.

A note about SBUX. Despite the recent challenges it has around overseas store performance and senior leadership turnover, it still trades for approximately 24x earnings. The reason SBUX retains its value in the current environment is because of the community and brand it has developed. As we said earlier, SBUX sells more than just coffee, and its high multiple in the current market environment demonstrates that.

Name	RICK	SBUX
Type	Company-operated	Company-operated
Property Financing	Owned	Leased
Earnings	\$79,444	\$4,000,000
Tangible Assets	\$272,695	\$20,652,000
Tangible Equity	\$2,201	(\$16,163,100)
Total Debt	\$227,414	\$23,899,100
Market Capitalization	\$580,000	\$96,000,000
Return on Tangible Assets	29.1%	19.4%
Total Debt-to-Earnings	2.9x	6.0x
P/E Ratio	7.3x	24.0x

RICK Q3 2022 Cash Flow & Valuation	
Net Income	\$13,942
Depr. Minus Maint Capex	\$1,672
Deferred Income Tax	(\$409)
Gain on Sale	(\$442)
Impairment of Assets	\$1,326
Debt Discount Amort	\$63
Noncash Lease Expense	\$487
Gain on Insurance	(\$67)
Doubtful Accounts	\$539
Quarterly Cash Flow	\$17,111
Annualized	\$68,444
New Clubs	\$5,000
Two San Antonio Clubs	\$2,500
New Bombshells & Franchisees	\$3,500
Run Rate Cash Flow Forecast	\$79,444
Shares Outstanding	9,390
per Share Free Cash Flow	\$8.46
Starbucks' Multiple	24.0x
RICK Intrinsic Value	\$203.06

Nightclubs: Significant Acquisition Opportunities

Market

- 2,200 clubs / ~500 meet our acquisition criteria
- We are one of the largest, but our market share is minimal
- Long-term owners interested in selling
- We are the acquirer of choice as the only public company in the space with access to bank financing

Financial Dynamics







- Buy earnings accretive clubs at 3-5x adjusted EBITDA
- Purchase related real estate at market value
- Strong record paying off seller financing from acquisition cash flow

Recent Acquisitions (October-November 2021)

- 12 clubs in 7 states
- Pre-COVID 2019: Generated \$40M in revenues and \$14M in Adjusted EBITDA

Current Acquisition Target

- Buy clubs that can add \$20M of Adjusted EBITDA in FY23

Our Top Club Brands	
	Elegant clubs with restaurants
	High-end, high-energy party club
	Nation's mega club with 74,000 square feet
	High-end clubs for African-American professionals
	Lively BYOB clubs for blue collar patrons and the college crowd
	Lively BYOB clubs for blue collar patrons and the college crowd



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New Technology to Drive Club Traffic

- Bitcoin Acceptance at Selected Locations
- Tip-N-Strip NFT Guest Benefits Program
- AdmireMe.com Mobile Friendly Website



www.tip-n-strip.io



www.admireme.com

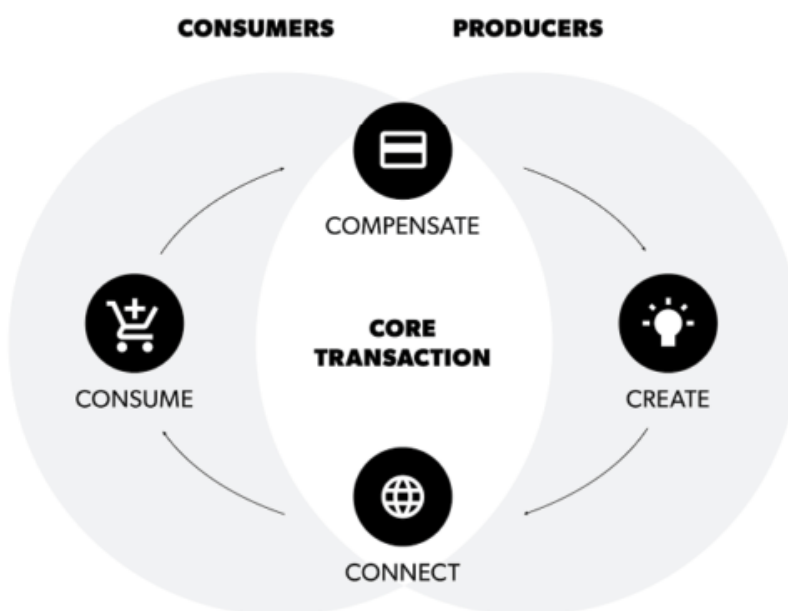


RICK's Future: The Apple Analogy

What does tomorrow hold for RICK?

Apple, Inc. (Nasdaq: AAPL) is an intriguing analogy. Both AAPL and RICK operate platform businesses that create value by bringing together different customer groups, which, in turn, is creating springboards for the sale of new products and services.

With the release of their book, *Modern Monopolies*, Alex Moazed and Nicholas Johnson coined a new industry focused on platform businesses. According to them, "A platform is a business model that creates value by facilitating exchanges between two or more interdependent groups, usually consumers and producers. In order to make these exchanges happen, platforms harness and create large, scalable networks of users and resources that can be accessed on demand. Platforms create communities and markets with network effects that allow users to interact and transact."⁸

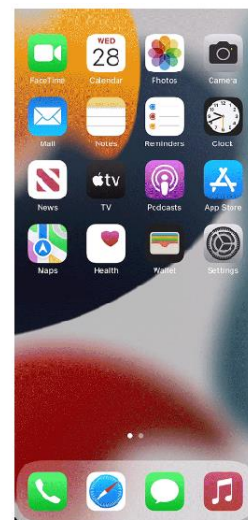


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Using this framework, AAPL enables users of smartphones to access services provided by software developers, whereas RICK provides services that enable customers to access content created by independent entertainers.

⁸ <https://www.applicoinc.com/>

⁹ <https://www.applicoinc.com/blog/what-is-a-platform-business-model/>



Through its subsidiaries, RICK owns and operates physical locations, develops and maintains management “operating systems” within its nightclubs, and enables entertainers to monetize their services on the main stage, floor, or in VIP rooms.

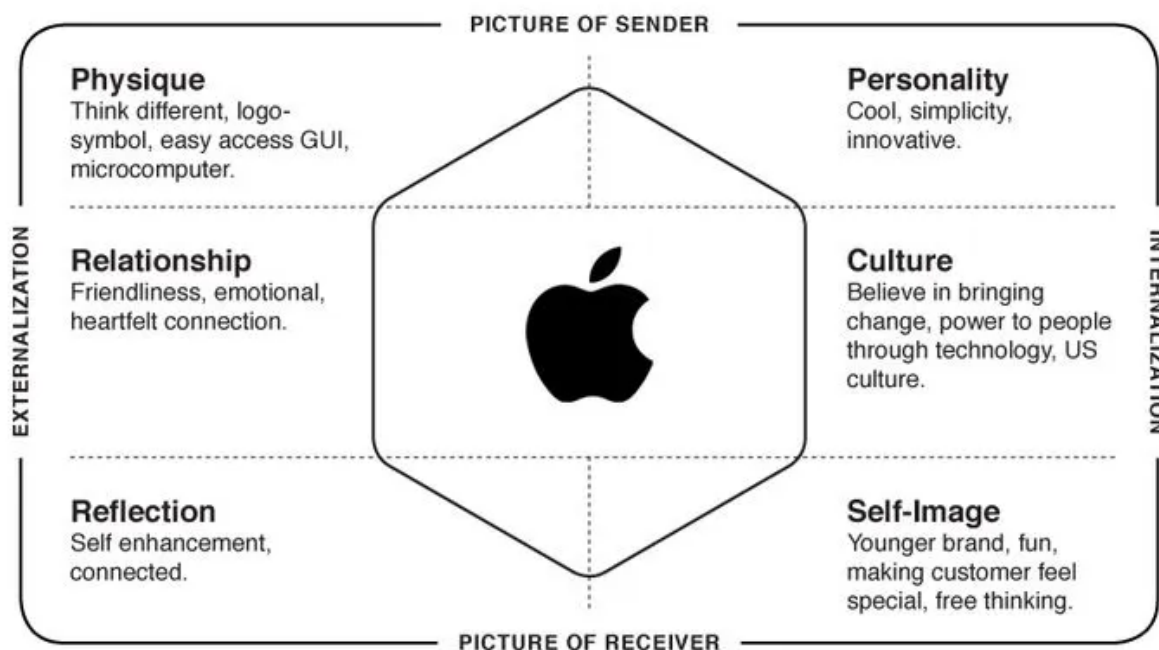


AAPL creates a community of users and developers on its platform. Users come to the Apple platform to find useful services. Developers use the platform to earn money. Likewise, RICK creates a community around its clubs. Customers come to nightclubs for a good time and to fulfill fantasies, and entertainers use RICK’s clubs to earn a living.

Subsequently, AAPL has been able to use its platform to create a growing number of new revenue opportunities. It has Apple TV, advertising, iTunes, earbuds, Apple health, Apple Car, and other products and services. Likewise, RICK is adding products and services, such as the Tip-N-Strip customer benefits program, the AdmireMe social media platform, and its Red Bull alternative Robust—all of which are or could be providing exciting new revenue streams. It is highly likely that in future years both companies will use their platforms to create other new revenue streams that are hard for investors to envision today.

Decades ago, Steve Jobs drilled into employees' minds "don't sell products, sell dreams."¹⁰ Today, AAPL successfully builds an emotional attachment, identity, and culture around its products. AAPL sells more than technology. It gives users a sense of belonging and identity. AAPL does this through Apple stores, phone packaging, personalization of the iPhone (what reflects our identity more than what we have on our phone lock/home screen?), product launches, customer support, and community forums.

BRAND IDENTITY PRISM



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RICK is also building brands that resonate on an emotional level and communities that connect customers and entertainers around the country. RICK CEO Eric Langan outlined his vision at a recent industry convention (emphasis added):

"...Social media, and specifically having a social media strategy, is so important to your marketing. You have to communicate in the language and style of this new generation of young men. It's not easy. I've been working on it for about six months now. I've hired experts to come in, to help us develop it, and build our social media presence.

¹⁰ <https://postcron.com/en/blog/10-amazing-marketing-lessons-steve-jobs-taught-us/>

¹¹ <https://fisovee.wordpress.com/2019/07/17/brand-identity-the-apple-way/>



RCI President & CEO Eric Langan

“You need to understand what this demographic wants. And what **they want are real-life experiences**. Unfortunately for them, most of their so-called ‘real-life experiences’ are on their computer screens. They have friends they’ve known for years who they’ve never met in real life. **We have to get them to understand they have a place to go. They can come to our clubs. They can meet at our clubs. They can have fun at our clubs. We can make our clubs their place to escape.**

“A big thing for them is to ‘touch grass,’ meaning an experience out in the real world. We need to get them to think of our clubs as the place where they’re going to touch that grass, to be around people, to have a great experience. To do that, we can’t be perceived by them as ‘strip clubs.’ We need to become ‘adult nightclubs,’ places where adults go to party and play. This means your club has to be fun and energetic. This means state-of-the-art sound and visuals. This means the entertainers are no longer the sole attraction, but help make the party. At other clubs, guys must be the aggressor and talk to the girls. At our clubs, entertainers want to talk to the guys and have fun with them...

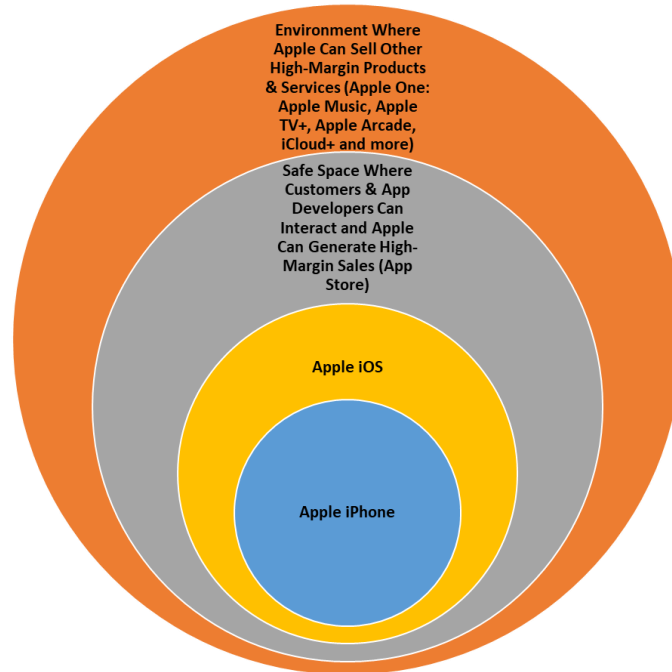
“For example, when they buy a bottle, it’s sparkling lights and lots of girls. Take this customers’ fantasy to the next level. Others want to become their avatar. We’ve thrown some parties through Twitter or another one of our social media sites. Nobody goes by their real names. You get a group of 40 or 50 guys and none of them know who they really are. They live in a fantasy world every day, on their computers, in their video games, and on their social media. **But that’s beautiful for us. Why? Our clubs are in the business of bringing a taste of fantasy to life.** Look at how entertainers use fake names. Nobody wants to date Suzy, the mother of three. But then she puts on her lingerie, does her makeup and her hair, and becomes ‘Alexis,’ the fun-loving party girl who’s ready to do shots with you. These young men are looking for a similar opportunity to be their avatar...



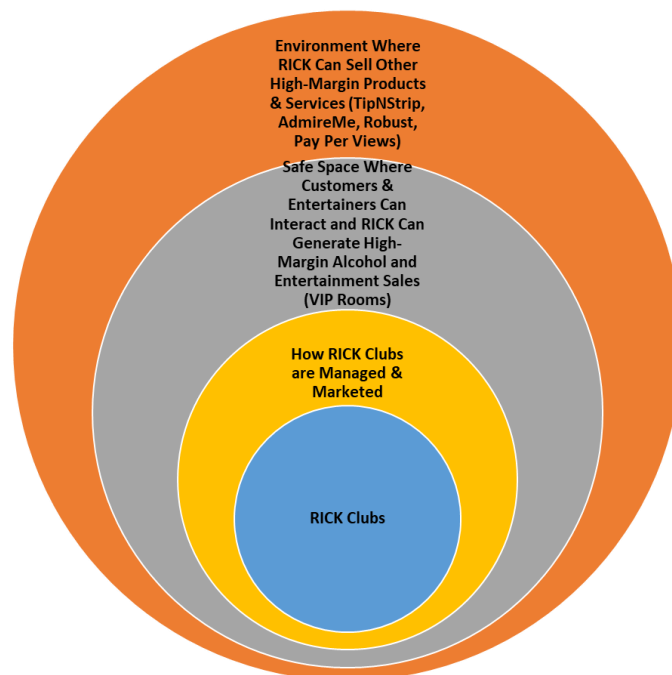
“But what we can do is change and adapt and engage. If you don’t engage, all your marketing is absolutely worthless. In social media today, if somebody asks a question, and no one answers, you’re totally irrelevant. But if a customer has a question, that shows he has some interest. And if you engage him, you’ll create that back-and-forth interactive experience, and you will create a loyal, return customer. **This demographic of young men develops close relationships with brands they buy or interact with, especially products or services that are experience-based. So I urge you — keep evolving. Keep engaging.**”¹²

¹² <https://exoticdancer.com/expo-coverage-rcis-eric-langan-on-present-future-of-adult-club-industry/>

The Apple Model



The RICK Model



Jeff Bezos: Getting the Analogy Right



Lauren Sanchez and Jeff Bezos¹³

In 2004, in order to decide how to invest and grow Amazon for the next several decades, Jeff Bezos needed to find the correct metaphor for the Internet and the transformation that was taking place. He rejected the common analogy of comparing the Internet boom and bust of the late 1990s-early 2000s to the 1849 Gold Rush. Instead, he framed the Internet, and by extension Amazon, using the electricity metaphor (emphasis added).¹⁴

“...If we look at what happened on the Internet, with such an incredible last half a dozen years, that it’s hard to even get the right analogy for it. A lot of how we decide, how we’re supposed to react to things and **what we’re supposed to expect about the future depends on how we bucket things and how we categorize them...**

“And that was, of course, the very common story. Because when you take out that last piece of gold –and they did incredibly quickly. I mean, if you look at the 1849 Gold Rush –the entire American river region, within two years –every stone had been turned. And after that, only big companies who used more sophisticated mining technologies started to take gold out of there.

¹³ <https://www.dailymail.co.uk/femail/article-11081583/Lauren-Sanchezs-accessories-London-vacation-Jeff-Bezos.html>

¹⁴ <https://davidsnotes.substack.com/p/jeff-bezos-on-the-electricity-metaphor>

“There’s a much better analogy that allows you to be incredibly optimistic and that analogy is the electric industry. There are a lot of similarities between the Internet and the electric industry. They are both thin, horizontal, enabling layers that go across lots of different industries. It is not a specific thing. They both can be used as incredible means of transmitting power. They both are an incredible means of communicating information flows.”

Like many internet investors in 2004, contemporary equity capital markets are not using the correct framework to analyze RICK. Instead of focusing on the low valuation, RICK investors should compare the company to SBUX, which creates an immersive experience and sense of community leading to a large share of the customer mind. To get an idea of what the future holds, investors should think about AAPL, a platform business that creates an identity and sells dreams.

Studying these analogies makes us incredibly optimistic about RCI Hospitality Holdings, Inc.

Fairlight Capital LLC is an alternative investment manager, based in Greenwich CT. Fairlight was featured as one of the “Top Performing Equity Strategy Hedge Funds in 2021 by Net Returns” in the 2022 Preqin League Tables. It was also named “Best Emerging Manager Fund – Equity Hedge” by the Hedgeweek Americas Awards 2021. Fairlight Capital has extensive experience analyzing microcap stocks and special situations.