RCI Hospitality Holdings

Initial take

2023-01-04

RCI Hospitality Holdings ("RCI" or the "Company") operates, through its subsidiaries, 56 nightclubs and 13 sports bars throughout the southern and southwestern United States. The company was founded in 1983 and listed on the NASDAQ in 1995. RCI is growing primarily through M&A of nightclubs and expansion of the company's sports bar concept (Bombshells) and sales consist primarily of alcohol, service (entrance fees etc) and food. The company has two segments: Nightclubs and Bombshells.

Strong cash generation

RCI's gross margin amounts to approximately 87% on a rolling twelve-month basis. At the same time, the company has efficient cash conversion cycles and a maintenance capex corresponding to approximately 3% of sales. This enables the company to generate an FCF margin of approximately 20% over time.

Value-creating capital allocation

Cash flow, in turn, is allocated in accordance with RCI's capital allocation strategy. Depending on the company's valuation, cash flow is allocated either to the acquisition of new nightclubs, organic expansion of sports bars or share buybacks. Repurchases are carried out when the company's FCF yield is above 10%. The target of the capital allocation is to grow FCF/share by 10-15% annually. Since 2015, FCF/share has increased by 18.8% annually.

2023 and Outlook

As pandemic restrictions eased in 2021, demand for RCI's services increased significantly. However, the situation has normalized during fiscal 2023. At the same time, a weakened macroeconomic situation and extreme heat wave in Texas have had a negative impact on the company's demand. Despite organic headwinds, the company's sales have increased during fiscal 2023, primarily driven by the acquisition of five nightclubs, and for 2024, the number of units is expected to increase by at least 14%. At today's levels, we believe RCI is attractively valued at a P/FCF of 9.7x on 2024E, which we believe is far too low given the company's growth potential, oligopolistic market positions and defensive elements.

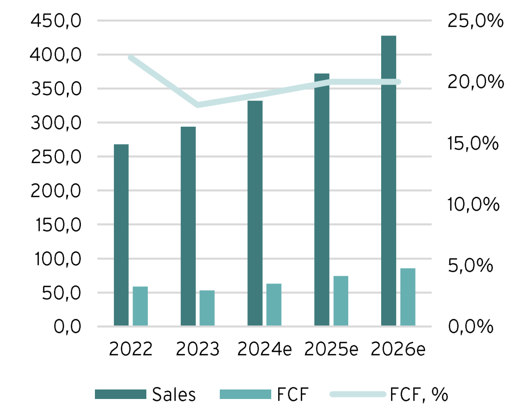
(MUSD)	2022	2023	2024E	2025E	2026E
Net sales	**267,6**	**293,8**	**332,3**	**373,5**	**428,0**
Growth y-o-y	*37,0%*	*9,8%*	*13,1%*	*12,4%*	*14,6%*
EV/S	3,2	2,9	2,5	2,3	2,0
Adj. EBITDA*	**86,7**	**85,1**	**98,7**	**112,4**	**129,3**
EBITDA margin	*32,4%*	*29,0%*	*29,7%*	*30,1%*	*30,2%*
Growth y-o-y	*44,0%*	*-1,8%*	*16,0%*	*13,9%*	*15,0%*
EV/EBITDA	9,8	9,9	8,6	7,5	6,5
Free cash flow**	**58,9**	**53,2**	**64,1**	**75,1**	**86,9**
FCF Margin	*22,0%*	*18,1%*	*19,3%*	*20,1%*	*20,3%*
Growth y-o-y	*63,2%*	*-9,7%*	*20,5%*	*17,1%*	*15,7%*
P/FCF	10,6	11,7	9,7	8,3	7,2
ND/Adj. EBITDA	**2,6**	**2,6**	**2,2**	**2,0**	**1,7**

**before settlement costs and write-downs*
***before growth-related investments*

Facts

CEO	Eric Langan
List	Nasdaq
Ticker	RICK
Share Price (USD)	66,9
Number of shares (M)	9,3
Market Cap (MUSD)	624,8
Net debt (MUSD)	221,7
EV (MUSD)	846,5
Insider ownership	8,4 %

Financial history and estimates (MUSD)



Analyst

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Share price, %	1 m	3 m	12m
RCI Hospitality	13,5%	6,7%	-29,3%

Key Insights

Low valuation

On a rolling twelve-month basis, RCI is valued at EV/addj. EBITDA 9.9x and P/FCF 11.7x. Based on the company's growth potential, moats and what peers are valued at, we believe that P/FCF 20x is justified.

High insider ownership

CEO and Chairman Eric Langan owns approximately 7.7% of the company. In total, the remaining members of the management group and the Board of Directors own 0.7% of the company.

Growth potential

In the Nightclubs segment, RCI wants to own 200 units in the long term. Today, the company owns 56 units. In other words, RCI wants to almost quadruple the number of units in the coming years, which will primarily be done through M&A.

"All the pieces are at place, we just need to continue what we do"

- Eric Langan, CEO of RCI Hospitality

Investment case

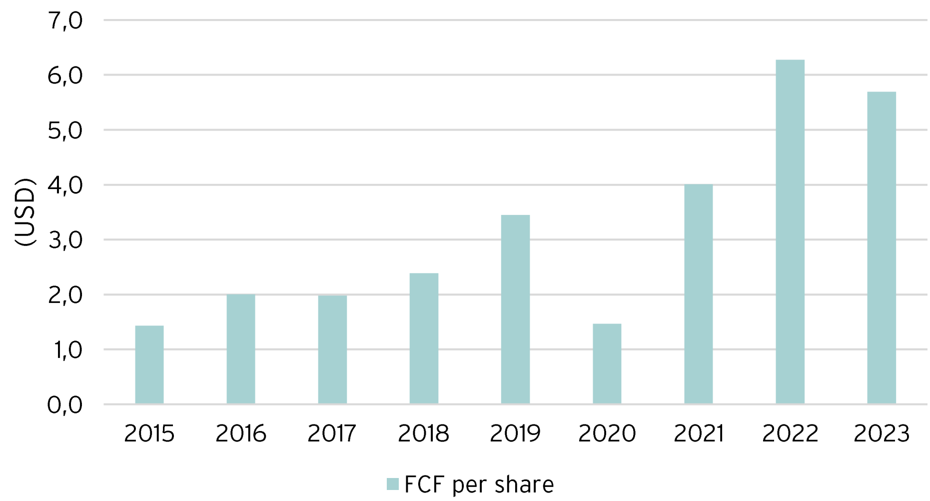
- Low valuation
- High insider ownership
- High growth potential
- Long history
- High barriers to entry
- Value-creating capital allocation
- Efficient checkout conversion
- Strong financial track record

History

Rick's Cabaret, as the company was formerly known, was founded by Robert Watters in Houston, Texas in 1983. In 1995, Rick's Cabaret went public on Nasdaq and in 1998, the company merged with XTC Cabaret, which was controlled by RCI's current CEO and chairman Eric Langan. In 1999, Langan bought out Watters and took control of the company.

In 2015, RCI came into conflict with the company's financial advisers after the advisers tried to get RCI to acquire an illegal club. The intrigue resulted in RCI's dismissal of the advisers. In connection with this, Langan was contacted by an investment firm from California. The firm gave him the book The Outsiders by William E. Thorndike. The book changed the company's view of capital allocation.

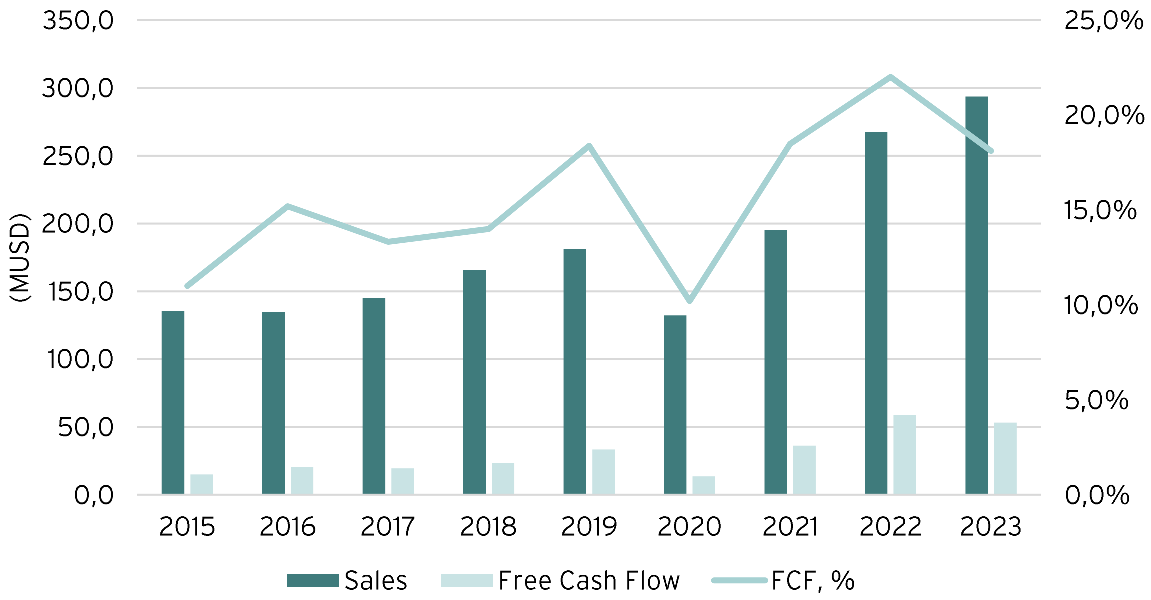
After Langan read the book, RCI established a clear capital allocation strategy in 2016. The company began to sell properties to clubs that generated poor returns, streamlined the organization and established a regulatory framework for risk-taking. The regulations stipulated that the company should only take on risk if they believe they will generate a return equivalent to three times their current FCF yield. Since the implementation of the capital allocation strategy, free cash flow per share has increased by approximately 19% annually.



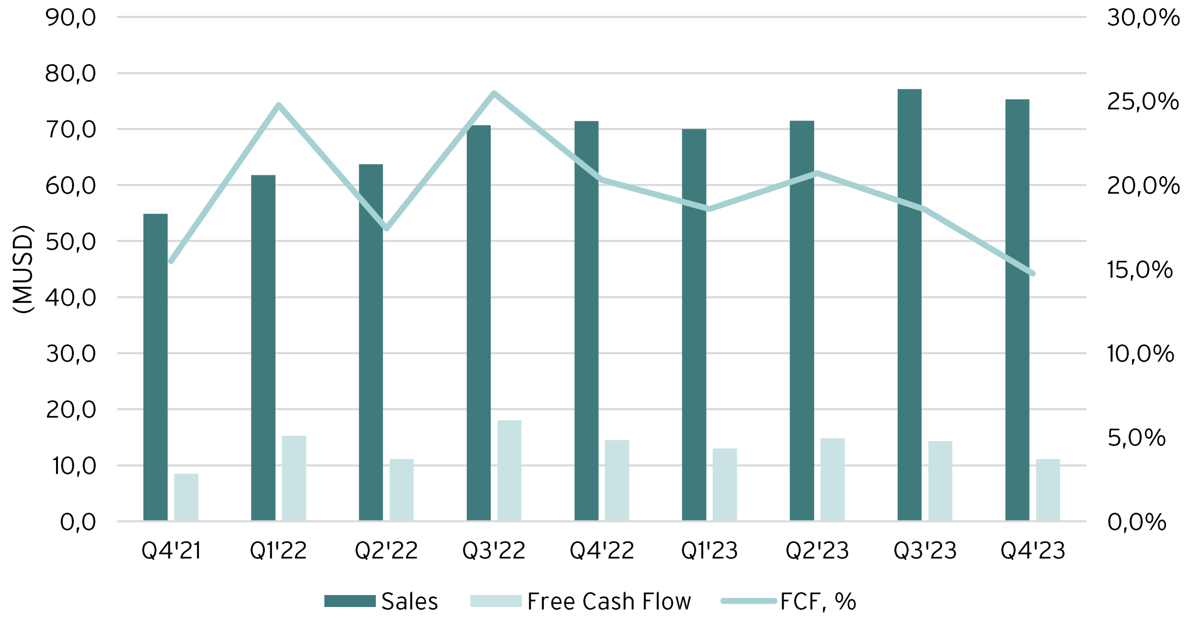
1983	Robert Watters founds Rick's Cabaret in Houston, Texas
1995	Rick's Cabaret goes public on Nasdaq
1998	Rick's Cabaret merges with XTC Cabaret
1999	Eric Langan buys out Robert Watters and takes control of the company
2005	The company's first club in New York opens
2007	Rick's Cabaret acquires the world's largest nightclub, Tootsie's Cabaret, in Miami, Florida
2013	The company's first Bombshells Restaurant & Bar opens
2014	Rick's Cabaret changes name to RCI Hospitality
2016	Capital allocation strategy established
2021	RCI Hospitality acquires 11 nightclubs for a purchase price of $88.0m, which is the largest acquisition in the company's history
2022	RCI Hospitality Signs Three-Location Bombshells Franchise Agreement in Alabama

Financial history

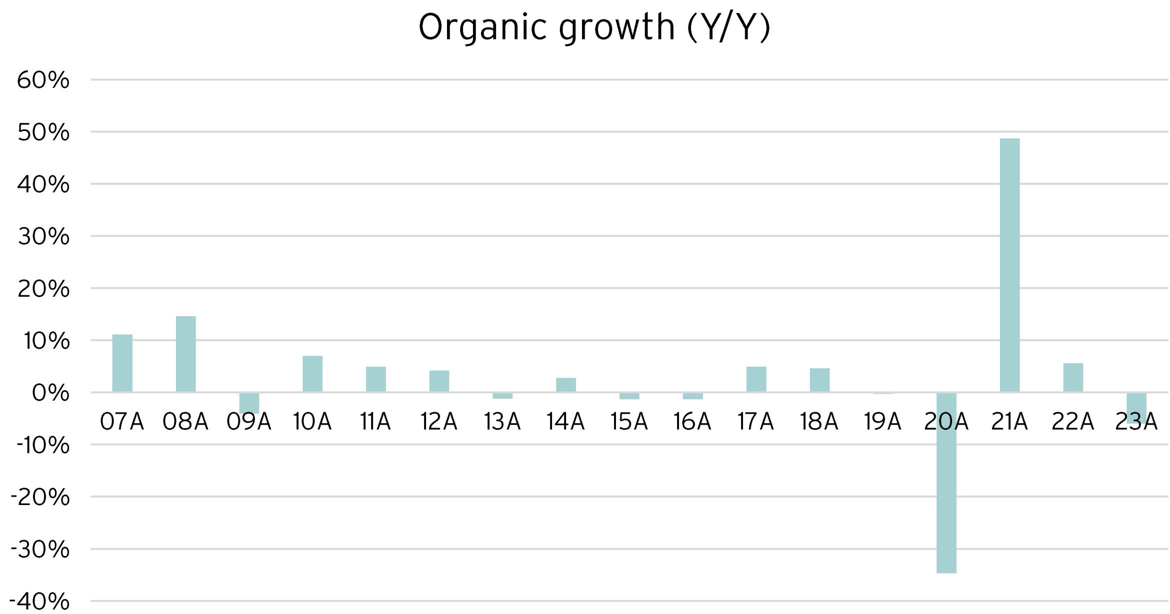
Apart from the pandemic, free cash flow has developed strongly since 2015. Over time, RCI wants the FCF margin to be at least 20%. In 2023, the FCF margin has been slightly below the company's target and since 2015, the average annual growth rate of net sales and free cash flow has been 10.2% and 17.2%, respectively.



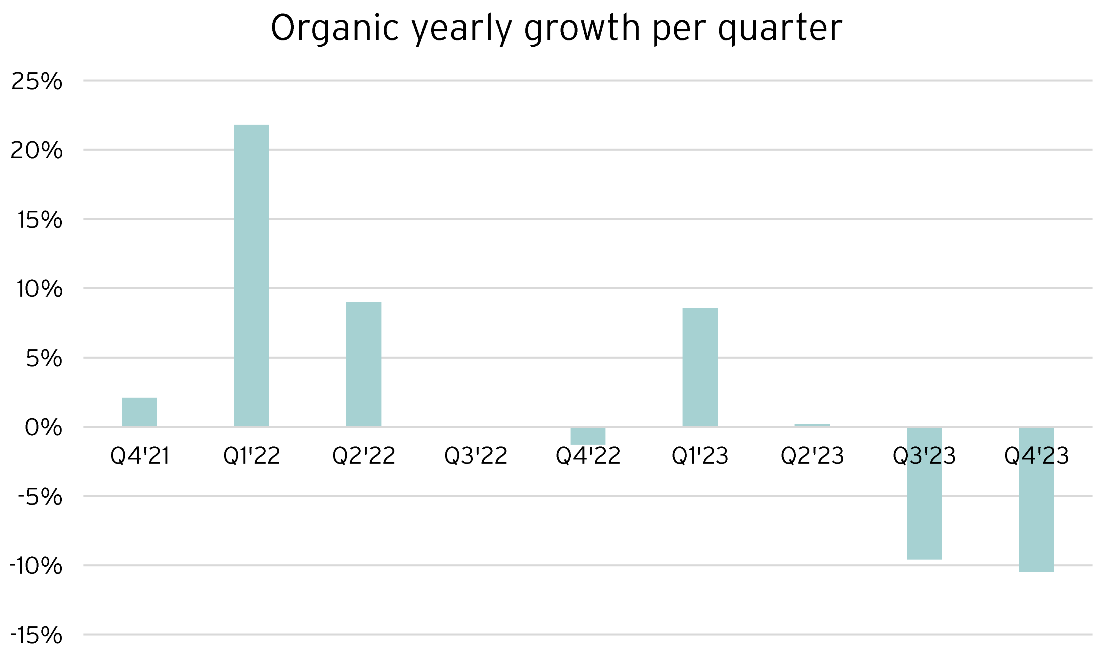
In recent quarters, the FCF margin has declined. The decrease is mainly attributable to a normalization of demand after the pandemic, a weaker macroeconomy and extreme heat in Texas during the summer. The business is affected by seasonal factors and historically H1 tends to be stronger than H2.



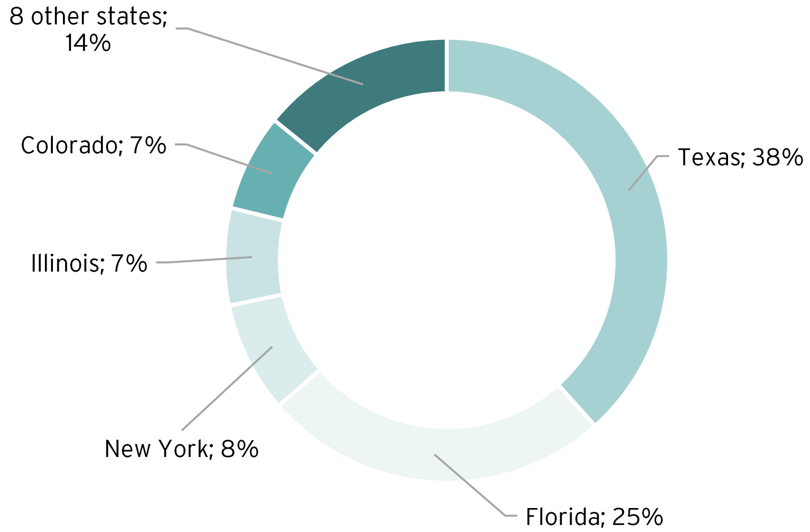
Excluding the pandemic years of 2020 and 2021, the average annual organic growth has been around 3% since 2007. Despite the fact that many investors have the impression that nightclubs are a highly cyclical business, organic growth only declined by about 7% during the 2009 financial crisis. As a result of the resilience of the business, RCI was instead able to take advantage of lower market prices in 2009 to further consolidate the industry.



Organic growth has been negative in the last two quarters. For example, by adjusting marketing, prices and product offerings within the company's units, a weaker macroeconomy tends to only have a negative impact on RCI for a couple of quarters.

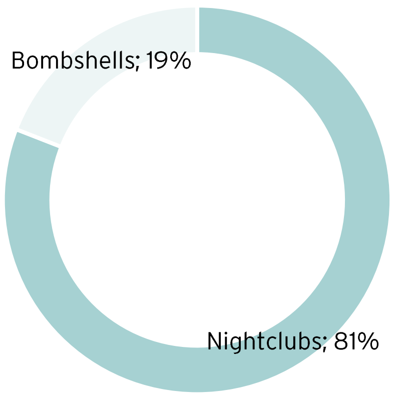


Texas and Florida are the company's most important markets. In 2022, revenues from the markets represented approximately 63% of the company's total sales. In 2022, the geographical breakdown was as follows:

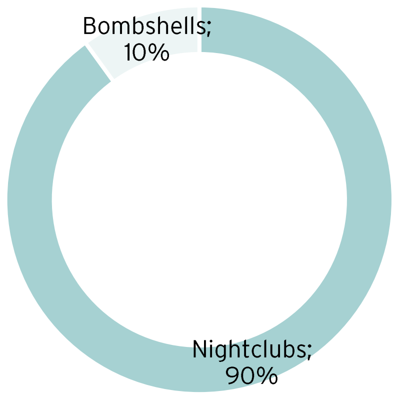


Nightclubs are RCI's core segment and represent the majority of the company's total net sales and profitability. In 2023, Nightclubs and Bombshells have accounted for the following shares of RCI's total net sales and EBITDA contribution:

Share of Net sales



Share of EBITDA contribution



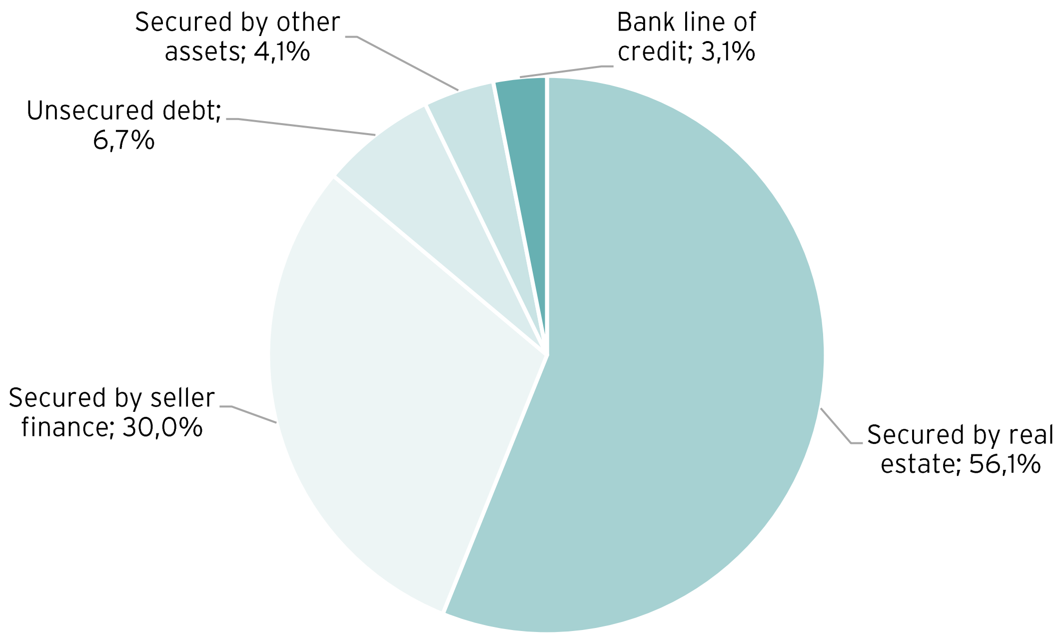
Since the implementation of the capital allocation strategy, RCI has used fluctuations in the company's share price to its advantage. Repurchases have been made when the FCF yield is above 10% and an issue for financing of acquisitions has taken place when the FCF yield is lower than 10%.

Repurchase				
Fiscal year	Repurchased shares (in thousands)	Accumulated (in thousands)	Average price (USD)	Accumulated (USD)
2015	225,3	225,3	10,2	10,2
2016	747,1	972,4	9,8	9,9
2017	89,7	1 062,0	12,2	10,0
2018	0	1 062,0	0	0
2019	128,0	1 190,1	22,7	11,4
2020	516,1	1 706,2	18,4	13,5
2021	74,7	1 780,8	24,0	14,0
2022	268,2	2 049,0	56,3	19,5
2023	34,1	2 083,1	64,5	19,9

Issue to finance acquisitions				
Fiscal year	Repurchased shares (in thousands)	Accumulated (in thousands)	Average price (USD)	Accumulated (USD)
2021	500,0	500,0	60,0	60,0
2023	200,0	700,0	80,0	65,7

Financial position

In Q4'23, total interest-bearing liabilities amounted to $242.7m. The average interest rate was around 6.7%. Approximately 56% of the company's total interest-bearing liabilities are secured by real estate and the average interest rate on these liabilities amounts to approximately 5.6%.



Interest-bearing debt	Average interest rate, %
Secured by Real Estate	5,6%
Secured by vendor promissory note	7,0%
Unsecured debt	12,0%
Secured by other assets	5,6%
Banking line of credit	9,5%

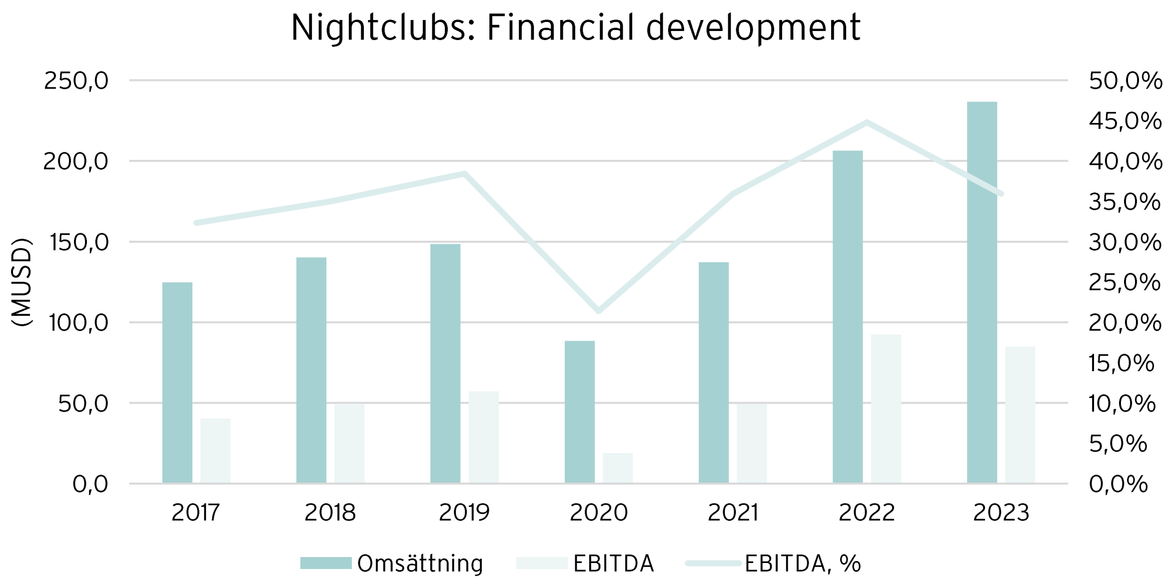
In Q4'23 net debt amounted to $221.7m and in comparison to Q3'23 net debt has decreased by $1.6m. ND/adj. EBITDA amounts to 2.6x on a rolling twelve month basis. CEO Langan wants to keep ND/adj. EBITDA below 3x over time. In 2023, interest expenses corresponded to approximately 5% of the company's sales and compared to 2022, interest expenses increased by approximately 36.1% in 2023.

We consider RCI's balance sheet to be solid. Due to the fact that the majority of the interest-bearing liabilities are secured by assets, and thus have low interest rates, we do not consider the debt situation to be strained despite the fact that ND/adj. EBITDA amounts to 2.6x on a rolling twelve month basis. RCI's properties represent approximately 46.2% of the company's total assets and approximately 45.2% of RCI's market capitalization today.

Nightclubs

RCI, through its subsidiaries, operates 56 nightclubs located throughout the southern and southwestern United States. The club portfolio consists of high-quality brands, such as Rick's Cabaret, Tootsie's Cabaret, Scarlett's Cabaret, Vivid Cabaret, Club Onyx, Jaguars Club, XTC Cabaret and Diamond Cabaret. Tootsie's Cabaret in Miami Gardens, Florida is the world's largest nightclub and the revenue from the club makes up about 15% of RCI's annual revenue.

In 2023, 44% of the segment's sales came from service (entrance fees etc), 41% from sales of alcohol, and 16% from sales of food and other. Since 2018, the average annual growth in segment net sales and EBITDA has been 11.1% and 11.6%, respectively. In 2023, the gross margin for the segment amounted to approximately 89%.



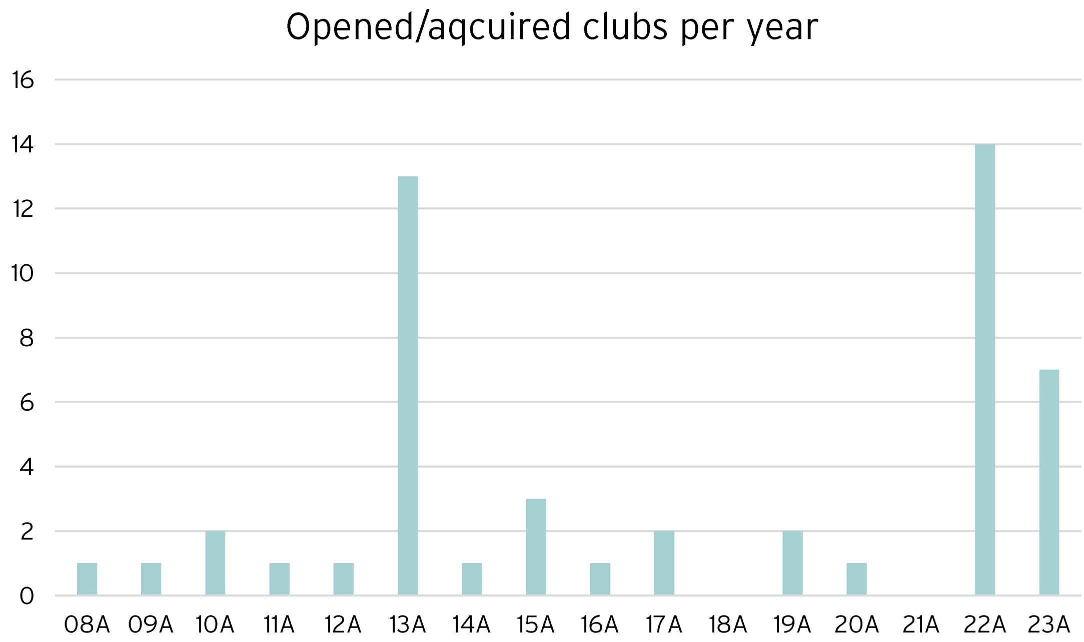
M&A

It's hard to run clubs. It requires expertise and long experience and besides, most people don't want to be associated with owning a strip club. At the same time, many club owners are planning to retire in the coming years. That's where RCI comes in to the picture.

RCI knows how to run clubs and has done so for decades. Unlike other players in the industry, the company is listed on the stock exchange, which results in increased access to capital and high credibility. RCI has a long history of successful M&A and the company has never missed a payment to the sellers. CEO Langan is keen to treat the sales staff well, both during and after the process.

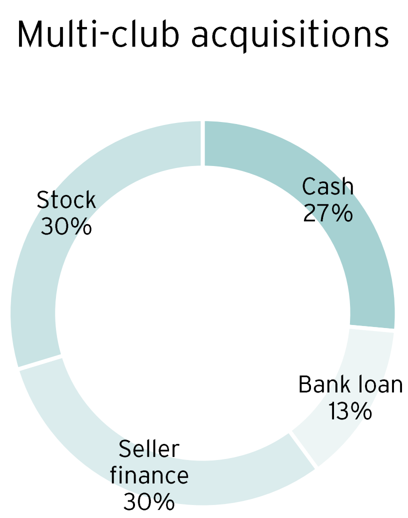
As a result, RCI is the sole and preferred buyer on the market. This enables the company to typically be able to buy clubs at 4-5 times the club's annual EBITDA, excluding the property, and subsequently generate a return on invested cash flow of at least 25% to 33%.

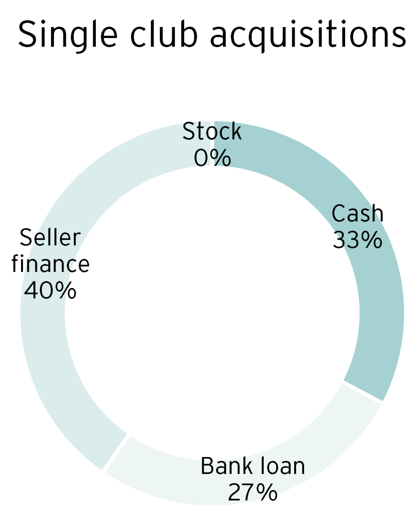
The pace of acquisitions has accelerated in recent years. In 2021, the company acquired 11 clubs in six states and associated properties for $88.0m in one go, representing the largest acquisition in the company's history by purchase price. At the end of 2022, the company announced the acquisition of 5 clubs in Texas and since 2019, the number of clubs has almost doubled. We believe that the accelerated acquisition rate represents an inflection point for the company and we expect the deterioration to continue going forward.



There are approximately 2,200 clubs in RCI's total addressable market. Approximately 500 of these clubs meet the company's quality parameters and in the long term, the company wants to own 200 clubs. As RCI only operates 56 clubs as of Q4'23, our assessment is that the company is still in the starting blocks of its journey.

Typically, RCI finances the acquisitions through a combination of existing cash and cash flow, seller notes, bank loans and shares. As a result of owning approximately 90% of the properties on which their units are located, RCI is able to generate high returns on the cash flow invested through favourable loan structures. The distribution of funding differs depending on the size of the transaction. Since 2016, the average funding for the acquisition of several clubs at the same time and the acquisition of individual clubs has been as follows:





A seller note is a claim that the seller has for an as yet unpaid part of the purchase price. RCI amortises the seller note on a monthly basis to the sellers using the acquired club's own cash flow. The note is advantageous from a tax point of view for the sellers, and for RCI it acts as a security, while the structure allows for aggressive consolidation of the industry. If RCI discovers that something is wrong with the newly acquired club, they have the option of offsetting the vendor note within a two-year period from the acquisition.

Thanks to RCI's economies of scale and industry knowledge, margins and sales for a newly acquired club tend to increase after the takeover. RCI integrates the new club into the company's culture and improves its strategies. For example, storage capacity is usually maximized, new security systems are installed, pricing strategies change, and ATM fees are introduced. RCI stated in connection with its recent acquisition that the newly acquired clubs' annual EBITDA was expected to increase by 30% to 45% following the synergy gains.

Unit economy

The unit economy varies depending on the market, club size, competition, and regulatory constraints on the business. Local restrictions on alcohol sales and dancers can negatively impact the entity's finances. But generally speaking, the company's nightclubs have good unit economy. With gross margins of approximately 90%, EBITDA margins of approximately 40% and an investment requirement of only 3-4% of revenues, the units generate strong cash flows. The investment need is related to the maintenance of the interior inside the clubs.

Barriers to entry, competition, and advantages

To build a new club, a license is required. The license is tied to the property on which the club is located. Due to zoning regulations, it is difficult to build new and profitable clubs today because the licenses are difficult to obtain in economically favorable locations. For example, clubs may be prohibited from building in residential areas or within a certain distance of schools and churches.

In RCI's key markets, the licenses for the company's clubs were obtained prior to the implementation of the zoning rules. In these markets, the company therefore experiences limited to non-existent competition. The segment's strong monopolistic position is reflected in its gross margin, which in the previous twelve months amounted to around 90%.

The industry is fragmented and the company's closest competitors are Spearmint Rhino and Deja Vu. Although RCI has a small market share, they are one of the biggest players in the market. The company's advantages over its competitors include, for example, economies of scale, a strong culture, property ownership and local political involvement. The fact that RCI maintains good relations with regulators enables the company to prevent negative regulatory impact on the business.

Industry transformation

The nightclub industry has changed since the company started 30 years ago. Around the year 2000, cities across the United States began to introduce regulations, such as background checks and licensing requirements. As a result, the industry became more business-driven. The environment inside the clubs has also changed over the years. The music and light shows have changed while more people are walking around inside the clubs. Today, the environment of RCI's clubs depicts "nightclubs with exotic dancers inside" rather than traditional strip clubs. The demographics inside the clubs have also changed drastically and today 30-40% of RCI's customer base are women.

ESG
According to the company, their club business is misunderstood. Some believe that the clubs exploit women, which according to the company is wrong. Instead, the company argues that the clubs offer women a chance to achieve financial independence, especially for the less fortunate. Women who have previously danced at RCI's clubs, and who then worked their way up within the company or used the money for an education, testify to a professional and humane culture inside the clubs. According to several of the women, the clubs' managers, who are largely women, treat the dancers with respect.

However, RCI has been involved in various lawsuits related to how they classify their dancers inside the clubs. On a number of occasions, the company has misclassified its dancers as independent contractors in order to avoid paying out insurance and minimum wage. As a result, RCI has had to pay damages on a number of occasions over the past decades.

Provided RCI manages its clubs in accordance with local law, it can be argued that there is nothing ethically wrong with the business model.

Risks
There are several risks related to the strip club industry. Perhaps the most obvious is the regulatory risks. Other risks related to the industry include misclassification of independent contractors and deteriorating macroeconomics.

Regulatory risks
The regulation of strip clubs in the United States varies significantly by state and city. Federal laws generally play a limited role when it comes to regulating nightclubs, and instead, state and local governments are often in charge. The states and local authorities can enact regulations and zoning regulations that dictate where clubs may be located, their opening hours, licensing requirements, and other operational aspects. In the event of a violation of local regulations, such as alcohol, health and safety laws, the club's license may be revoked.

Despite the fact that some of the company's clubs have been questioned over the years, only a few have been forced to close completely. It's hard to shut down a club completely in the United States. Profitable clubs generate tax revenue and due to the low income tax rates in many of RCI's main markets, the authorities are more reliant on corporate income tax. Local authorities are generally not in favour of closing down clubs.

Misclassification of independent contractors
The majority of RCI's dancers are classified as independent contractors. Classifying the dancers as independent contractors is the industry standard and is regulated at the state and federal levels. Independent contractors have no insurance and are not guaranteed an income. Instead, they get to keep the majority of the revenue that they generate at the club. Under the Fair Labor Standards Act, you cannot be considered an independent contractor if your employer requires a specific hourly schedule, establishes a dress code, or determines the price that you can charge your clients.

It happens that nightclubs misclassify their dancers as independent contractors (when they should really be classified as employees and entitled to minimum wage). Over the years, dancers have challenged nightclubs in courts and demanded minimum wages. In the vast majority of cases, the dancers win such lawsuits. Since 2009, RCI has been involved in dozens of lawsuits related to this issue. In total, the company has paid over $20m in settlement costs over the years:

Deteriorating macroeconomics

A deteriorating macroeconomy reduces demand for the company's products. On the other hand, RCI's nightclubs have historically shown resilience in economic downturns. An example of this is how RCI's nightclubs showed single-digit positive average organic growth during the financial crisis.

RCI's business model has several defensive elements that enable the company to stand firm as household finances weaken in the US. Firstly, about 40% of the total turnover comes from alcohol. Alcohol is a defensive commodity that is consumed regardless of the economic climate. Second, RCI owns 90% of the properties on which their units are located, which means that they are not significantly affected by rent increases during periods of high inflation. Instead, they can keep prices low and gain market shares from competitors.

Bombshells

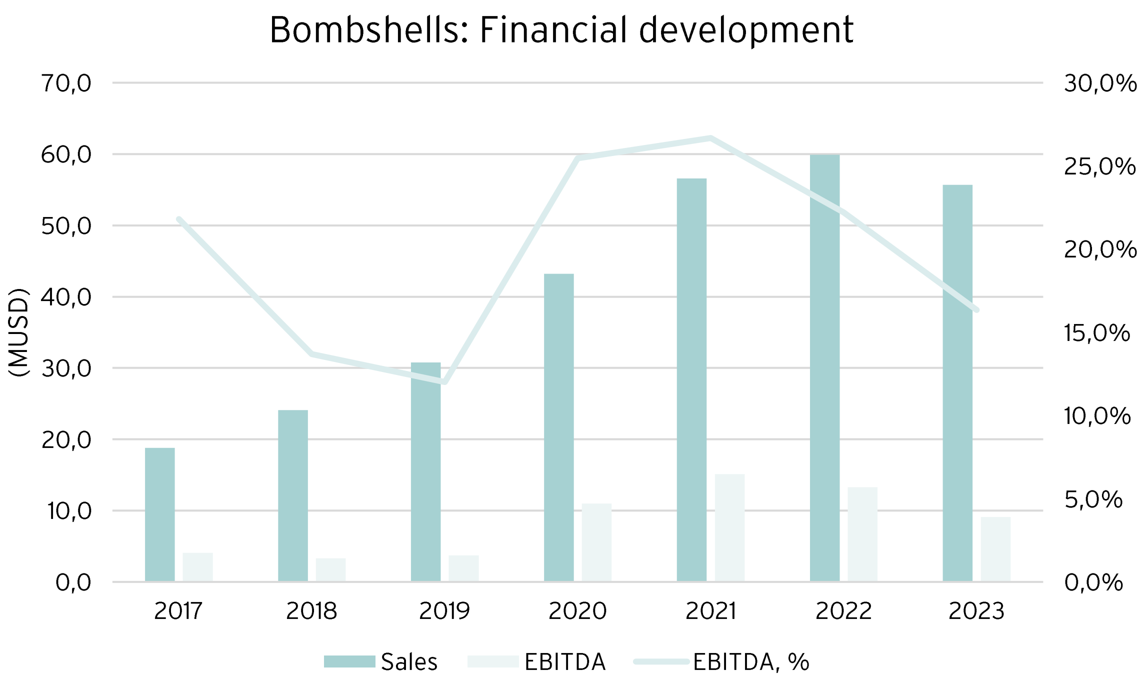
Since RCI wants to acquire nightclubs at reasonable prices, it is impossible to know when the next acquisition will be made because they rely on someone else to sell to them. In order to not have long periods of inefficient capital allocation consisting of excessive cash build-up, RCI started Bombshells in 2013. Within Bombshells, the company can control the growth rate.

Bombshells is a military-themed Texas restaurant and bar chain that attracts a broad demographic of men, women, and families. Inside the units, "Bombshells Girls" is a main attraction, while the restaurant's large and numerous TVs attract sports fans.

Including the property, it requires an investment of approximately $6-7 million to build a Bombshell unit. As a result of RCI's property ownership, the investment is largely financed by loans. Due to the fact that the majority of Bombshell's sales originate from alcohol, leading to high margins, payback periods have historically been short and the return on invested capital high.

Today, RCI operates 13 Bombshells units around Texas. In the coming years, RCI wants to significantly increase the number of Bombshells units and introduce the concept to new markets through various types of collaborations, such as franchise agreements. In the long term, RCI wants to expand the number of units to 80-100.

In 2023, approximately 56% of the segment's sales came from sales of alcohol and approximately 44% from sales of food. Since 2018, the average annual growth in segment net sales and EBITDA has been 18.2% and 22.5%, respectively. In 2023, the segment's gross margin amounted to approximately 78%.



Pandemic

As a result of a court victory, Bombshells was open during the pandemic unlike many other restaurants and bars in Texas. The chain had a temporary monopolistic position, which resulted in a sharp increase in margins. CEO Langan warned that margins were unsustainable, and as pandemic restrictions eased, competition increased. This has resulted in reduced margins for Bombshells.

Strategic review and valuation

In Q4'23, RCI announced that it has initiated a strategic review of Bombshells. The review means that the company is considering different types of collaborations or a possible sale of the segment. The rationale for the review is that RCI wants to focus on the acquisition of nightclubs as it creates the most value for shareholders:

Return on Assets 2023	
Bombshells	Nightclubs
7,6 %	15,1 %

To value Bombshells, we have chosen to apply a multiple to the segment's EBITDA in 2023. The multiple is based on the segment's outlook and risks, as well as what peers are valued at. We have defined peers to Bombshells as US companies in the restaurant industry that show a positive EBITDA result over the past twelve months. We have identified about 40 companies that match our definition of peer to Bombshells. The following is our peer compilation:

Peers					
Company	EV ($m)	Turnover-% 5y	EBITDA-% 5y	EV/S	EV/EBITDA
Arcos Dorados	3 955,2	6,3%	26,9%	0,9	8,7
ARK Restaurants	149,5	3,2%	5,4%	0,8	11,4
Biglari	225,6	-14,4%	5,9%	0,6	3
BJs Restaurants	1 275,1	3,9%	-8,1%	0,9	14,7
Bloomin Brands	4 233,0	2,1%	9,2%	0,9	7,9
Brinker	3 901,5	5,4%	-1,2%	0,9	10,9
Carrols	1 611,7	9,4%	7,9%	0,9	12,0
Cheesecake Factory	3 440,8	8,2%	-5,0%	1,1	19,1
Chipotle	64 043,1	14,4%	28,4%	6,7	34,2
Chuys	768,4	2,4%	23,2%	1,7	11,7
Cracker Barrel Old	2 797,6	2,2%	-10,2%	0,8	12,3
Darden	24 814,2	4,8%	6,5%	2,3	15,2
Denny's	976,7	-5,7%	-6,2%	2,1	13,4
Dine Brands	2 242,6	1,3%	0,2%	2,7	10,9
Dominos Pizza	19 290,8	5,4%	7,9%	4,3	21,1
El Pollo Loco	561,2	1,6%	4,2%	1,2	9,9
FAT Brands	1 303,1	87,5%	38,7%	3,1	65,5
FlaniganS	73,0	8,5%	7,6%	0,4	4,9
Good Times Restaurant	76,0	7,0%	77,3%	0,5	10,6
Jack In The Box	4 626,2	14,2%	3,0%	2,7	13,7

Kura Sushi	672,5	29,4%	-9,0%	3,6	303,3
McDonald's	256 109,6	3,5%	9,1%	10,2	18,8
Nathan's Famous	337.4	5,7%	-3,5%	2,5	9,7
Noodles & Co.	436,4	2,4%	7,6%	0,8	16,4
Papa Johns	3 348,2	5,9%	21,0%	1,6	16,6
Potbelly	437,5	2,8%	10,3%	0,9	21,4
Rave Restaurant	29,7	-0,5%	12,4%	2,4	9,8
Red Robin	736,1	-0,8%	-12,6%	0,6	17
Restaurant Brands	35 676,2	5,2%	0,4%	5,2	16,7
Shake Chess	2 913,6	17,8%	10,1%	2,8	29
Starbucks	130 839,8	7,8%	0,4%	3,6	17,7
Texas Roadhouse	8 330,2	12,7%	11,0%	1,9	17,1
The One Group	331,4	31,1%	24,0%	1,0	13,0
Wendy's	7 632,6	6,5%	-8,1%	3,5	14,2
Wingstop	7 982,2	23,4%	24,6%	18,2	64,3
Yum Brands	45 851,7	4,4%	0,1%	6,5	18,8
Yum China	15 980,9	4,7%	3,8%	1,5	10,4
Median	**2 797,2**	**5,4%**	**6,5%**	**1,7**	**14,2**
Bombshells	n.a	18,2%	22,5%	n.a	n.a

Due to the fact that Bombshell's peers show scattered numbers, we choose to focus on the median in our compilation. In summary, the median valuation amounts to EV/EBITDA of 14.2x. At the same time, the median annual EBITDA growth over the past five years is 6.5%. During the same period, Bombshell's EBITDA has increased by 18.2% annually.

We believe that Bombshells should be valued at a premium in comparison to peers. As a result of Bombshell's historical growth, growth potential and high alcohol sales, we believe that an EV/EBITDA of 16.0x is justified. On a rolling twelve-month basis, RCI is valued at EV/EBITDA of 9.9x.

Bombshells Enterprise Value		
EBITDA R12 ($m)	EV/EBITDA	Enterprise Value ($m)
9,1	16,0	145,6

According to our assessment, Bombshell's enterprise value could reach $145.6m, which is roughly equivalent to 17% of RCI's current enterprise value.

We are very pleased that RCI is considering a sale of the Bombshells segment. As a result of the segment's declining profitability, it is now significantly more value-creating for shareholders if RCI uses the cash flow to acquire new clubs or repurchase shares instead of building new Bombshells units. In addition, the company's new segment, Casinos, can hopefully replace Bombshell's role in the capital allocation strategy.

Casinos

In May 2021, the state of Colorado removed restrictions on maximum bets when gambling. As a result, gambling turnover in the state has increased. In 2024, RCI is looking to open two casinos in Central City, Colorado: Rick's Cabaret Steakhouse & Casino and Bombshells Sports Casino. Central City is 1 of 3 cities in Colorado with legalized gambling and today there are 6 casinos in the city. On the market, the daily average earnings per slot machine amount to $131 and annually more than $1B is wagered on slots.

As of Q4'23, RCI had not yet obtained a license for casino operations or alcohol sales from authorities in Colorado. However, the company has received planning permission for Rick's Cabaret Steakhouse & Casino and construction of the unit has begun in Q1'24. Bombshells Sports Casino is still awaiting planning permission.

Rick's Cabaret Steakhouse & Casino

Rick's Cabaret Steakhouse & Casino is expected to be approximately 3,000 square feet spread over four floors. The number of slot machines is expected to be around 200. RCI estimates that the total investment can generate high returns and that potential annual EBIT from the unit could exceed Bombshell's entire EBIT during 2023.

Potential Returns for Rick's Cabaret Steakhouse & Casino	
Investment for building and real estate	$2.4m
Investment for interior	$9.0m
Total investment	**$11.4m**
Number of slot machines	200 pieces
Expected daily average earnings per machine	$252.0 USD
Annual turnover	**$18.4m**
Expected EBIT margin	40 %
Annual EBIT	**$7.4m**
Total investment	$11.4m
Annual EBIT	$7.4m
Return on invested capital	**64,6 %**

Ownership

Outstanding shares	Share price	Market capitalization
9 349 685	66.9 USD	USD 624.8 million
Number of shareholders (Ava)	**Insider ownership**	**Free float**
203	8,4 %	75,5 %

Management and Board of Directors	Number of shares	Value (MUSD)	Capital	Votes
1. Eric Langan (CEO & Chairman)	723 870	48,5	7,7 %	7,7 %
2. Bradley Chhay (CFO)	25 474	1,7	0,3 %	0,3 %
3. Yura Barabash	961	0,1	0,0 %	0,0 %
4. Travis Reese	34 541	2,3	0,4 %	0,4 %
5. Luke Lirot	518	0,0	0,0 %	0,0 %
6. Elaine Martin	9 085	0,6	0,0 %	0,0 %
7. Arthur Allan Priaulx	2 000	0,1	0,0 %	0,0 %

Other major shareholders	Number of shares	Value (MUSD)	Capital	Votes
1. ADW Capital Partners	941 000	63,0	10,0 %	10,0 %
2. Blackrock	575 106	38,5	6,1 %	6,1 %

Insider ownership

Insiders owns a total of 792,709 shares in the company, corresponding to 8.4% of the capital and votes. All insiders on the board and management own shares in the company. We like the fact that all insiders own shares as this creates incentives to create shareholder value.

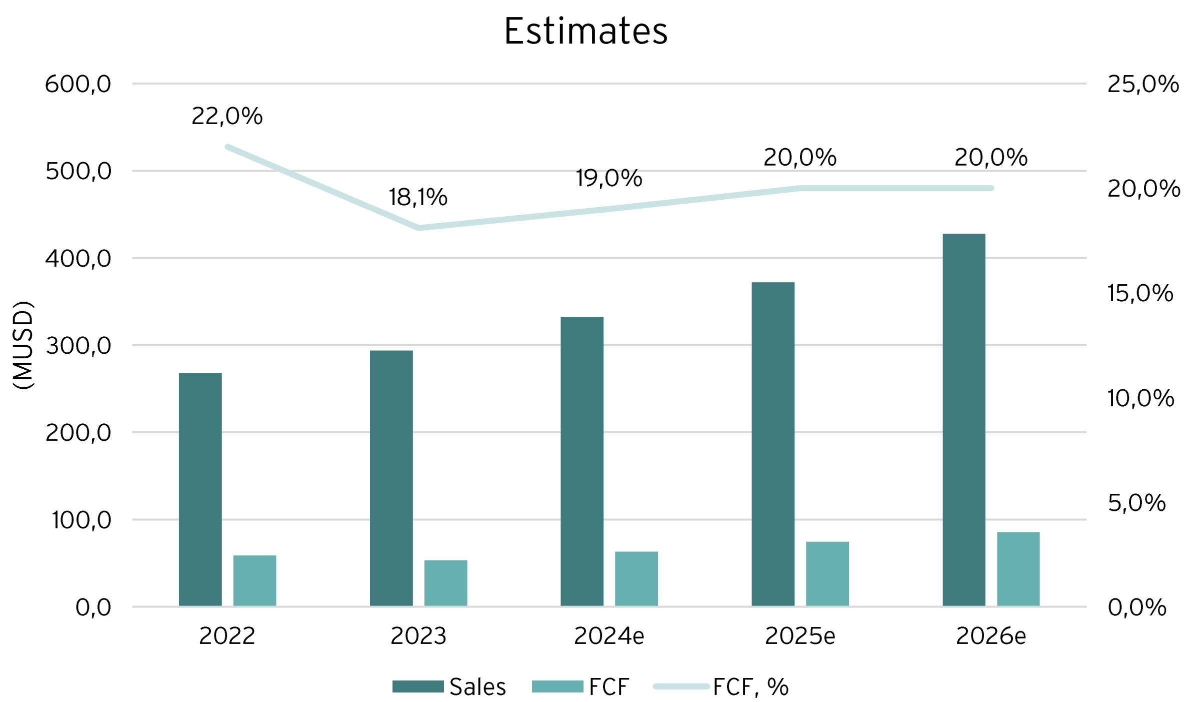
Current situation and outlook

Despite macroeconomic headwinds, extreme heat in Texas, demand normalizing post-pandemic and VIP customers vacationing abroad, RCI has increased sales by about 10% while the FCF margin only declined from about 22% to 18% in 2023. CEO Langan is very optimistic about 2024.

In 2024, the number of cash-flow generating units is expected to increase: three new clubs are scheduled to open in Texas, three new Bombshells are scheduled to open in Texas and Colorado, and two casinos are scheduled to open in Colorado. This corresponds to an increase in the number of units of approximately 14%. In addition to this, CEO Langan announced in Q4'23 that they are actively looking for acquisitions and that they are in dialogue with a number of club owners. If acquisitions are completed, we believe that the number of active units could increase by 20-25% in 2024.

Our assessment is that RCI is well placed to create significant value for its shareholders over time. The company has a unique position in a fragmented market with high barriers to entry, while management has a clear focus on maximizing return on invested capital to grow free cash flow per share. We expect the company to continue to consolidate the nightclub industry in the U.S. and to quadruple the number of active club units in the long term. At the same time, we expect Bombshells to be sold off, casinos to open and start generating significant cash flow, and buybacks to occur when FCF yield exceeds 10%.

We believe that defensive elements, such as alcohol sales and property ownership, will enable RCI to generate stable cash flows despite macroeconomic headwinds. The sustainable cash flow enables the company to use the market turmoil to its advantage and thereby acquire new clubs and repurchase shares at low prices. Examples of when the company has used the market turmoil to its advantage are during the financial crisis, when Tootse's was acquired, and during the pandemic, when significant buybacks were carried out.



Valuation

Key stats			
Number of shares	9 349 685	Net debt (MUSD)	221,7
Price per share (USD)	66,9	Enterprise value (MUSD)	846,5
Market Capitalization (MUSD)	624,8		

Rolling 12 months			
Net sales	USD 293.8 million	P/S	2,1
Adj. EBITDA	USD 85.1 million	EV/adj. EBITDA	9,9
EBIT	USD 67.1 million	EV/EBIT	12,9
FCF	USD 53.2 million	P/FCF	11,7

Historical average

	P/S	EV/EBITDA	EV/EBIT	EV/OP
Avg. 3 years	3,0	18,6	22,3	21,8
Average 5 years	2,2	15,0	17,5	17,6

Ratios

Gross margin	Adj. EBITDA margin	EBIT margin	Profit margin
86,8 %	29,0 %	22,8 %	10,0 %
OPCF Margin	**FCF Margin**	**ROE**	**ROC**
20,1 %	18,1 %	10,4 %	12,4 %

Estimate

(MUSD)	2022	2023	2024E	2025E	2026E
Net sales	**267,6**	**293,8**	**332,3**	**373,5**	**428,0**
% y-o-y	37,0%	9,8%	13,1%	12,4%	14,6%
P/S	*2,3*	*2,1*	*1,9*	*1,7*	*1,5*
Adj. EBITDA	**86,7**	**85,1**	**98,7**	**112,4**	**129,3**
Adj. EBITDA margin	*32,4%*	*29,0%*	*29,7%*	*30,1%*	*30,2%*
% y-o-y	44,0%	-1,8%	16,0%	13,9%	15,0%
EV/adj. EBITDA	*9,8*	*9,9*	*8,6*	*7,5*	*6,5*
Free cash flow	***58,9***	***53,2***	***64,1***	***75,1***	***86,9***
FCF Margin	*22,0%*	*18,1%*	*19,3%*	*20,1%*	*20,3%*
% y-o-y	63,2%	-9,7%	20,5%	17,1%	15,7%
P/FCF	*10,6*	*11,7*	*9,7*	*8,3*	*7,2*

Despite the company's low ESG profile, we choose to value RCI at a multiple of FCF 20x on 2026E. The multiple is motivated by the company's value-creating capital allocation, long-term growth potential, oligopolistic market positions and defensive elements. RCI is geographically diversified, which reduces regulatory and macroeconomic risks at Group level, and since the implementation of the capital allocation strategy, the company has created significant value for shareholders. In our opinion, the company is well placed to continue to create significant value in the coming years.

Valuation				
	Multiple	FCF 26E	Market Capitalization (MUSD)	Share Price (USD)
2026E	20	86,9	1 737,8	186,1
Safety margin (30%)	*20*	*60,8*	*1 216,4*	*130,2*

Potential return						
	Main scenario			Safety margin (30%)		
	Factor	Percent	CAGR	Factor	Percent	CAGR
2026E	2,8	178,1%	40,6%	1,9	94,7%	24,9%

Sensitivity analysis						
	Main scenario 2026E			Safety margin (30%)		
FCFx	Market Capitalization (MUSD)	Share Price (USD)	Change %	Market Capitalization (MUSD)	Share Price (USD)	Change %
16	1 390,2	148,8	122,5%	973,1	104,2	55,7%
18	1 564,0	167,5	150,3%	1 094,8	117,2	75,2%
20	**1 737,8**	**186,1**	**178,1%**	**1 216,4**	**130,2**	**94,7%**
22	1 911,5	204,7	205,9%	1 338,1	143,3	114,1%
24	2 085,3	223,3	233,7%	1 459,7	156,3	133,6%
26	2 259,1	241,9	261,5%	1 581,4	169,3	153,1%

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Conflict of interest

Jacob Stjernberg owns shares in the analyzed company.

The analysis is not a commissioned analysis.