RCI HOSPITALITY HOLDINGS, INC.
Form 10-Q
August 11, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2014

¨ TRANSITION REPORT PURSUANT TO 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)

RICK'S CABARET INTERNATIONAL, INC.

(Former name of registrant)

Texas	**76-0458229**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

10959 Cutten Road

Houston, Texas 77066

(Address of principal executive offices) (Zip Code)

(**281**) **397-6730**

(Registrant's telephone number, including area code)

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 x No ¨

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer £ Accelerated filer S Non-accelerated filer £ Smaller reporting company £

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of July 31, 2014, 10,138,777 shares of the registrant's Common Stock were outstanding.

NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q 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, in Part I, Item 2 “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 continue,” “will 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 Quarterly Report on Form 10-Q 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 affects on our financial condition and results of operations include, but are not limited to, the risks and uncertainties related to our future operational and financial results, competitive factors, the timing of the openings of other clubs, the availability of acceptable financing to fund corporate expansion efforts, our dependence on key personnel, the ability to manage operations and the future operational strength of management, and the laws governing the operation of adult entertainment businesses. 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.

As used herein, the “Company,” “we,” “our,” and similar terms include RCI Hospitality Holdings, Inc. (Formerly Rick’s Cabaret International, Inc.) and its subsidiaries, unless the context indicates otherwise.

RCI HOSPITALITY HOLDINGS, INC.

(Formerly RICK'S CABARET INTERNATIONAL, INC.)

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

RCI HOSPITALITY HOLDINGS, INC.

(Formerly RICK'S CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

(in thousands, except per share data)	June 30, 2014 (UNAUDITED)	September 30, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 11,102	$ 10,638
Accounts receivable:		
Trade, net	1,501	1,382
Other, net	741	328
Marketable securities	586	555
Inventories	1,797	1,472
Assets held for sale	3,177	-
Deferred tax asset	5,325	4,618
Prepaid expenses and other current assets	2,895	1,668
Total current assets	27,124	20,661
Property and equipment, net	112,697	98,629
Other assets:		
Goodwill	43,987	43,987
Other indefinite lived intangibles	55,231	54,966
Definite lived intangibles	811	1,065
Other	3,859	3,792
Total other assets	103,888	103,810
Total assets	$ 243,709	$ 223,100

See accompanying notes to consolidated financial statements.

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RCI HOSPITALITY HOLDINGS, INC.

(Formerly RICK'S CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

(in thousands, except per share data)	June 30, 2014 (UNAUDITED)	September 30, 2013
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 1,485	$ 1,816
Accrued liabilities	7,358	5,232
Texas patron tax liability	15,405	13,035
Current portion of long-term debt	13,079	8,830
Total current liabilities	37,327	28,913
Deferred tax liability	26,884	26,354
Other long-term liabilities	1,034	956
Long-term debt	69,304	69,762
Total liabilities	134,549	125,985
Commitments and contingencies		
PERMANENT STOCKHOLDERS' EQUITY:		
Preferred stock, $.10 par, 1,000 shares authorized; none issued and outstanding	-	-
Common stock, $.01 par, 20,000 shares authorized; 10,085 and 9,504 shares issued and outstanding, respectively	101	95
Additional paid-in capital	66,907	61,506
Accumulated other comprehensive loss	81	50
Retained earnings	38,946	32,130
Total RCIH’s permanent stockholders’ equity	106,035	93,781
Noncontrolling interests	3,125	3,334
Total permanent stockholders’ equity	109,160	97,115
Total liabilities and stockholders’ equity	$ 243,709	$ 223,100

See accompanying notes to consolidated financial statements.

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RCI HOSPITALITY HOLDINGS, INC.

(Formerly RICK'S CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)	FOR THE THREE MONTHS ENDED JUNE 30, (UNAUDITED)		FOR THE NINE MONTHS ENDED JUNE 30, (UNAUDITED)	
	2014	2013	2014	2013
Revenues:				
Sales of alcoholic beverages	$ 13,626	$ 11,105	$ 38,300	$ 32,554
Sales of food and merchandise	4,076	3,288	11,478	8,744
Service revenues	14,035	12,382	41,112	38,089
Other	1,606	1,533	4,746	4,790
Total revenues	33,343	28,308	95,636	84,177
Operating expenses:				
Cost of goods sold	4,295	3,680	12,083	10,561
Salaries and wages	7,219	6,413	20,650	18,600
Stock compensation	2	282	156	845
Other general and administrative:				
Taxes and permits	5,150	4,302	14,707	13,069
Charge card fees	479	409	1,356	1,126
Rent	1,315	846	3,699	2,199
Legal and professional	1,206	797	2,420	2,454
Advertising and marketing	1,420	1,187	4,111	3,452
Insurance	1,014	573	2,785	1,642
Utilities	650	523	1,891	1,564
Depreciation and amortization	1,532	1,341	4,438	3,987
Loss on sale of property	334	-	248	-
Settlement of lawsuits and other one-time costs	3,233	160	3,503	160
Other	2,602	2,335	7,624	6,973
Total operating expenses	30,451	22,848	79,671	66,632
Operating income	2,892	5,460	15,965	17,545
Other income (expense):				
Interest income	-	(2)	112	6
Interest expense	(2,060)	(1,868)	(5,996)	(5,274)
Gain on change in fair value of derivative instruments	-	1	-	2
Income before income taxes	832	3,591	10,081	12,279
Income taxes	203	1,343	3,448	4,533
Net income	629	2,248	6,633	7,746
	62	(53)	183	(159)

Less: net (income) loss attributable to noncontrolling interests				
Net income attributable to RCI Hospitality Holdings, Inc.	$ 691	$ 2,195	$ 6,816	$ 7,587
Basic earnings per share attributable to RCIH's shareholders:				
Net income	$ 0.07	$ 0.23	$ 0.70	$ 0.80
Diluted earnings per share attributable to RCIH's shareholders:				
Net income	$ 0.07	$ 0.23	$ 0.69	$ 0.79
Weighted average number of common shares outstanding:				
Basic	9,883	9,479	9,695	9,523
Diluted	9,968	9,647	9,922	9,871

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC.

(Formerly RICK'S CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share data)	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE NINE MONTHS ENDED JUNE 30,	
	2014	2013	2014	2013
	(UNAUDITED)		(UNAUDITED)	
Net income	$ 629	$ 2,248	$ 6,633	$ 7,746
Other comprehensive income:				
Unrealized holding gain (loss) on securities available for sale	13	(10)	31	(13)
Comprehensive income	642	2,238	6,664	7,733
Less: net (income) loss attributable to noncontrolling interests	62	(53)	183	(159)
Comprehensive income to common stockholders	$ 704	$ 2,185	$ 6,847	$ 7,574

RCI HOSPITALITY HOLDINGS, INC.

(Formerly RICK'S CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, except per share data)	FOR THE NINE MONTHS ENDED JUNE 30,	
	2014	2013
	(UNAUDITED)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$6,633	$7,746
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	4,438	3,988
Deferred taxes	225	(103)
Amortization of note discount	65	143
Gain on change in fair value of derivative instruments	-	(2)
Deferred rents	(17)	(42)
Stock compensation expense	156	845
Loss on sale of assets	248	-
Changes in operating assets and liabilities:		
Accounts receivable	(532)	(319)
Inventories	(324)	(208)
Prepaid expenses and other assets	(1,286)	(3,496)
Accounts payable and accrued liabilities	4,192	5,593
Cash provided by operating activities	13,798	14,145
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(11,822)	(5,497)
Proceeds from sale of marketable securities	-	500
Proceeds from sale of assets	223	-
Acquisition of development rights in New York building	(5,325)	-
Acquisition of businesses, net of cash acquired	(500)	(3,645)
Net cash used by investing activities	(17,424)	(8,642)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Purchase of put options and payments on derivative instrument	-	(139)
Payments on long-term debt	(5,899)	(7,219)
Proceeds from long-term debt	7,025	7,000
Exercise of stock options	3,126	-
Purchase of treasury stock	-	(1,478)
Distribution to minority interests	(162)	(162)
Cash provided by (used in) financing activities	4,090	(1,998)

NET INCREASE IN CASH	464	3,505
CASH AT BEGINNING OF PERIOD	10,638	5,523
CASH AT END OF PERIOD	$11,102	$9,028
CASH PAID DURING PERIOD FOR:		
Interest	$5,618	$4,753
Income taxes	$2,553	$3,389

See accompanying notes to consolidated financial statements.

Non-cash transactions:

During the nine months ended June 30, 2014, the Company incurred $4.9 million in seller-financed long-term debt in connection with the acquisition of real estate and an aircraft.

During the nine months ended June 30, 2014, the Company converted debt principal and interest valued at $2.1 million into 211,443 common shares.

During the nine months ended June 30, 2013, the Company purchased and retired 176,255 common treasury shares. The cost of these shares was $1,478,482.

During the nine months ended June 30, 2013, the Company incurred $13.6 million in debt in connection with the purchase of real estate and other assets.

During the nine months ended June 30, 2013, the Company issued warrants valued at $38,256 in connection with the issuance of debt.

See accompanying notes to consolidated financial statements.

RCI HOSPITALITY HOLDINGS, INC. (Formerly RICK'S

CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014

(UNAUDITED)

1. BASIS OF PRESENTATION AND NAME CHANGE

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q of Regulation S-X. They do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to the consolidated financial statements for the year ended September 30, 2013 included in the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission. The interim unaudited financial statements should be read in conjunction with those financial statements included in the Form 10-K. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting solely of normal recurring adjustments, have been made. Operating results for the nine months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending September 30, 2014.

At the Company’s Annual Meeting of Stockholders on August 6, 2014, stockholders approved changing its name to RCI Hospitality Holdings, Inc. (“RCIH”).

2. RECENT ACCOUNTING STANDARDS AND PRONOUNCEMENTS

The FASB has issued Accounting Standards Update (ASU) No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.* The amendments in the ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. It also addresses sources of confusion and inconsistent application related to financial reporting of discontinued operations guidance in U.S. GAAP. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization’s operations and financial results. Examples include a disposal of a major geographic area, a major line of business, or a major equity method investment. In addition, the new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more

information about the assets, liabilities, income, and expenses of discontinued operations. The new guidance also requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. This disclosure will provide users with information about the ongoing trends in a reporting organization's results from continuing operations. The amendments in the ASU are effective in the first quarter of 2015 for public organizations with calendar year ends. Early adoption is permitted. The Company has adopted this guidance beginning with the quarter ended March 31, 2014.

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The guidance in this update supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*. Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in ASU No, 2014-09 are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. We are currently evaluating the impact of adopting the guidance on our financial statements.

RCI HOSPITALITY HOLDINGS, INC. (Formerly RICK'S

CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014

(UNAUDITED)

3. SIGNIFICANT ACCOUNTING POLICIES

Following are certain remarkable accounting principles and disclosures.

Marketable Securities

Marketable securities at June 30, 2014 consist of bond funds. ASC 320, *Investments in Debt and Equity Securities*, requires certain investments be recorded at fair value or amortized cost. The appropriate classification of the investments in marketable equity is determined at the time of purchase and re-evaluated at each balance sheet date. As of June 30, 2014, the Company's marketable securities were classified as available-for-sale, which are carried at fair value, with unrealized gains and losses reported as other comprehensive income within the stockholders' equity section of the accompanying consolidated balance sheets. The cost of marketable securities sold is determined on a specific identification basis. The fair value of marketable securities is based on quoted market prices based on Level 1 inputs — quoted prices (unadjusted) for identical assets or liabilities in active markets.

There have been no realized gains or losses related to marketable securities for the nine month periods ended June 30, 2014 or 2013. Marketable securities held at June 30, 2014 have a cost basis of approximately $505,000.

Fair Value Accounting

ASC 820 clarifies the definition of fair value, describes methods used to appropriately measure fair value, and expands fair value disclosure requirements, but does not change existing guidance as to whether or not an instrument is carried at fair value.

US 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 gains and losses, net of the related income tax effect, if any, on available-for-sale securities are included in comprehensive 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 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. As of June 30, 2014, available-for-sale securities consisted of the following:

(in thousands) Available for Sale	Cost Basis	Gross Unrealized Gains	Fair Value
Tax-Advantaged Bond Fund	$505	$ 81	$586

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RCI HOSPITALITY HOLDINGS, INC. (Formerly RICK'S

CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014

(UNAUDITED)

3. SIGNIFICANT ACCOUNTING POLICIES - continued

In accordance with ASC Topic 320, *Investments — Debt and Equity Securities* , 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 loss in comprehensive income. No losses for other than temporary impairments in the Company's marketable securities portfolio were recognized during the quarter ended June 30, 2014.

Financial assets and liabilities measured at fair value on a recurring basis are summarized below:

(in thousands) June 30, 2014	Carrying Amount	Level 1	Level 2	Level 3
Marketable securities	$ 586	$ 586	$ -	$ -

(in thousands) September 30, 2013	Carrying Amount	Level 1	Level 2	Level 3
Marketable securities	$ 555	$ 555	$ -	$ -

Discontinued Operations

In prior consolidated financial statements, the Company has disclosed certain discontinued operations – nightclubs that the Company has closed or sold. Those discontinued operations have now become immaterial; therefore, the Company has eliminated the disclosure in the accompanying consolidated financial statements.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

4. STOCK OPTIONS AND STOCK-BASED EMPLOYEE COMPENSATION

Employee and Director Stock Option Plans

In 1995, the Company adopted the 1995 Stock Option Plan (the "1995 Plan") for employees and directors. In August 1999, the Company adopted the 1999 Stock Option Plan (the "1999 Plan") and in 2010, the Company's Board of Directors approved the 2010 Stock Option Plan (the "2010 Plan") (collectively, "the Plans"). The 2010 Plan was approved by the shareholders of the Company at the 2011 Annual Meeting of Shareholders. The options granted under the Plans may be either incentive stock options, or non-qualified options. The Plans are administered by the Board of Directors or by a compensation committee of the Board of Directors. The Board of Directors has the exclusive power to select individuals to receive grants, to establish the terms of the options granted to each participant, provided that all options granted shall be granted at an exercise price equal to at least 85% of the fair market value of the common stock covered by the option on the grant date and to make all determinations necessary or advisable under the Plans.

The compensation costs recognized for the three months ended June 30, 2014 and 2013 were $2,922 and $281,745, respectively, and were $156,449 and $845,325 for the nine months then ended, respectively. There were 269,665 and 369,665 stock option exercises aggregating $2.3 million and $3.1 million, respectively, during the three and nine months ended June 30, 2014. There were no stock option exercises for the three and nine months ended June 30, 2013. There were no stock option grants for the three and nine months ended June 30, 2014.

RCI HOSPITALITY HOLDINGS, INC. (Formerly RICK'S

CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014

(UNAUDITED)

4. STOCK OPTIONS AND STOCK-BASED EMPLOYEE COMPENSATION - continued

Stock Option Activity

The following is a summary of all stock option transactions for the nine months ended June 30, 2014:

(in thousands, except for per share and year information)	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of September 30, 2013	765	$ 8.41		
Granted	-	-		
Cancelled or expired	(22)	8.54		
Exercised	(370)	8.45		
Outstanding as of June 30, 2014	373	$ 8.36	0.16	$ 690
Options exercisable as of June 30, 2014	373	$ 8.36	0.16	$ 690

The 362,835 options exercisable as of June 30, 2014 expired on July 2, 2014.

5. GOODWILL AND OTHER INTANGIBLES

Following are the changes in the carrying amounts of goodwill and licenses for the nine months ended June 30, 2014 and 2013:

(in thousands)	2014		2013	
	Licenses	Goodwill	Licenses	Goodwill
Beginning balance	$54,966	$43,987	$50,608	$43,421
Intangibles acquired	-	-	4,358	997
Other	265	-	-	(431)
Ending balance	$55,231	$43,987	$54,966	$43,987

6. LONG-TERM DEBT

On October 15, 2013, the Company sold to certain investors (i) 9% Convertible Debentures with an aggregate principal amount of $4,525,000 (the “Debentures”), under the terms and conditions set forth in the Debentures, and (ii) warrants to purchase a total of 72,400 shares of the Company’s common stock (the “Warrants”), under the terms and conditions set forth in the Warrants. Each of the Debentures has a term of three years, is convertible into shares of our common stock at a conversion price of $12.50 per share (subject to adjustment), and has an annual interest rate of 9%, with one initial payment of interest only due April 15, 2014. Thereafter, the principal amount is payable in 10 equal quarterly principal payments, which amounts to a total of $452,500, plus accrued and unpaid interest. Six months after the issue date of the Debentures, we have the right to redeem the Debentures if the Company’s common stock has a closing price of $16.25 (subject to adjustment) for 20 consecutive trading days. The Warrants have an exercise price of $12.50 per share (subject to adjustment) and expire on October 15, 2016. In the event there is an effective registration statement registering the shares of common stock underlying the Warrants, we have the right to require exercise of the Warrants if our common stock has a closing price of $16.25 (subject to adjustment)

RCI HOSPITALITY HOLDINGS, INC. (Formerly RICK'S

CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014

(UNAUDITED)

6. LONG-TERM DEBT - continued

for 20 consecutive trading days. The Company sold the Debentures and Warrants to the investors in a private transaction and received consideration of $4,525,000. An adviser to the Company received compensation in the amount of $271,500 in connection with advising the Company regarding the sale of the Debentures and Warrants.

The fair value of the warrants was estimated to be $105,318 in accordance with FASB ASC 820, *Fair Value Measurements*, using a Black-Scholes option-pricing model using the following weighted average assumptions:

Volatility	28.4 %
Expected life	1.5 years
Expected dividend yield	-
Risk free rate	.33 %

The cost of the warrants has been recognized as a discount on the related debt and was amortized over the life of the debt.

In October 2013 the Company borrowed $ 2.5 million from an individual. The note is collateralized by a second lien on the Company’s Miami nightclub, bears interest at 13% and interest only is payable monthly until the principal matures in 36 months.

In December 2013 the Company purchased an aircraft for $4.3 million which was partially financed by a $3.6 million note to a bank. The note is payable $40,654 monthly, including interest at 7.45% until February 2017 when the entire principal balance becomes due.

In May 2014, the Company acquired certain real estate in Houston, Texas for the purpose of constructing a corporate headquarters building. The cost of the land was $707,000 and was partially financed with a $531,000 note, payable $18,151 per quarter until May 2019, including interest at 6.5%.

In October 2013, the Company acquired certain real estate in Beaumont, Texas. The cost of the property was $850,000 and was partially financed with a $700,000 note, payable $10,565 per month until October 2020. This property is now under contract for sale and is a portion of the assets held for sale in the accompanying consolidated balance sheet.

7. COMMON STOCK

During the nine months ended June 30, 2013, the Company purchased and retired 176,255 common treasury shares. The cost of these shares was $1,478,482. These shares have been retired.

During the nine months ended June 30, 2014, the Company converted debt principal and interest valued at $2.1 million into 211,443 common shares.

8. EARNINGS PER SHARE (“EPS”)

The Company computes earnings per share in accordance with FASB ASC 260, *Earnings Per Share*. ASC 260 provides for the calculation of basic and diluted earnings per 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 stock warrants and options (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”).

RCI HOSPITALITY HOLDINGS, INC. (Formerly RICK'S

CABARET INTERNATIONAL, INC.) AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014

(UNAUDITED)

8. EARNINGS PER SHARE ("EPS") - continued

Diluted EPS considers the potential dilution that could occur if the Company's outstanding common stock options, warrants and convertible debentures were converted into common stock that then shared in the Company's earnings (as adjusted for interest expense that would no longer occur if the debentures were converted).

	FOR THE QUARTER ENDED JUNE 30,		FOR THE NINE MONTHS ENDED JUNE 30,	
	2014	2013	2014	2013
Basic earnings per share:				
Net income attributable to RCIH's shareholders	$691	$2,195	$6,816	$7,587
Average number of common shares outstanding	9,883	9,479	9,695	9,523
Basic earnings per share - net income attributable to RCIH's shareholders	$0.07	$0.23	$0.70	$0.80
Diluted earnings per share:				
Net income attributable to RCIH's shareholders	$691	$2,195	$6,816	$7,587
Adustment. to net earnings from assumed conversion of debentures (1)	-	23	60	221
Adjusted net income attributable to RCIH's shareholders	$691	$2,218	$6,876	$7,808
Average number of common shares outstanding:				
Common shares outstanding	9,883	9,479	9,695	9,523
Potential dilutive shares resulting from exercise of warrants and options (2)	85	22	96	22
Potential dilutive shares resulting from conversion of debentures (3)	-	146	131	326
Total average number of common shares outstanding used for dilution	9,968	9,647	9,922	9,871
Diluted earnings per share - net income attributable to RCIH's shareholders	$0.07	$0.23	$0.69	$0.79

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

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

(3) Convertible debentures (principal and accrued interest) outstanding at June 30, 2014 and 2013 totaling $10.5 million and $5.3 million, respectively, were convertible into common stock at a price of $10.00 to $12.50 per share in 2014 and $10.00 to $10.25 per share in 2013. Potential dilutive shares amounting to $1.5 million and $1.4 million for the three and nine month periods ended June 30, 2014, respectively, have been excluded from earnings per share due to being anti-dilutive. Potential dilutive shares of 375,000 and zero for each of the three and nine month periods ended June 30, 2013, have been excluded from earnings per share due to being anti-dilutive.

* EPS may not foot due to rounding.

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9. ACQUISITIONS

Quarter Ended December 31, 2013

In October 2013, the Company purchased 49 percent of a corporation that operates the Dallas club “PT’s Platinum” and also acquired the building and personal property. Total cost of the transaction was $500,000. This subsidiary is being consolidated in the Company’s consolidated financial statements, effective as of the date of the purchase.

The following information summarizes the allocation of fair values assigned to the assets at the purchase date.

Buildings and land	$350
Property and equipment	20
SOB license	265
Minority interest	(135)
Net assets	$500

2013

In connection with the acquisition of the Foster Clubs, as explained in Note M in the Company’s Form 10-K for the year ended September 30, 2012, the Company’s wholly owned subsidiary, Jaguars Holdings, Inc. (“JHI”), entered into a Commercial Contract (the “Real Estate Agreement”), which agreement provided for JHI to purchase the real estate where the Foster Clubs are located. The transactions contemplated by the Real Estate Agreement closed on October 16, 2012. The purchase price of the real estate was $10.1 million (discounted to $9.6 million as explained below) and was paid with $350,000 in cash, $9.1 million in mortgage notes, including the assumption of approximately $4.2 million in notes, and an agreement to make a one-time payment of $650,000 in twelve years that bears no interest. The

note bears interest at the rate of 9.5%, is payable in 143 equal monthly installments and is secured by the real estate properties. The Company has recorded a debt discount of $431,252 related to the one-time payment of $650,000. The Company reduced previously recognized goodwill because the purchase of the Foster Clubs operations and the real estate were considered to be one purchase transaction with multiple closings and were included in the same purchase agreement.

The following information summarizes the allocation of fair values assigned to the assets at the purchase date.

Buildings and land	$10,066
Goodwill	(431)
Net assets	$9,635

On March 4, 2013, the Company completed the acquisition of a second adult business in midtown Manhattan. The Company then opened a new gentlemen's club at the 61 West 37th Street location, just east of Sixth Avenue. The Company paid $3 million for the business, with $1.5 million paid in cash and the remaining $1.5 million in six percent promissory notes convertible into shares of Company common stock. The notes call for monthly payments of $16,653, including principal and interest, and mature in 120 months. At the option of the noteholders, the principal amount of the notes and the accrued but unpaid interest thereon may be converted into shares of the Company’s common stock at $10.25 per share. The notes are redeemable by the Company at any time if the closing price of its common stock for 20 consecutive trading days is at least $13.47 per share.

The following information summarizes the allocation of fair values assigned to the assets and liabilities at the purchase date.

(in thousands)

Noncompete	$150
Goodwill	997
SOB licenses	2,850
Deferred taxes	(997)
Net assets	$3,000

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9. ACQUISITIONS - continued

The Company incurred approximately $34,000 in legal costs associated with the acquisition, which are included in legal and professional expense in the accompanying consolidated statement of income.

Goodwill in the acquisition represents the offset to the deferred tax liability recorded as a result of the difference in the basis of the net assets for tax and financial purposes. The goodwill is not deductible for income tax purposes. The results of operations of this company are included in the Company's consolidated results of operations since March 5, 2012. This acquisition was made to further the Company's growth objective of acquiring nightclubs that will quickly contribute to the Company's earnings per share. Proforma results of operations have not been provided, as the amounts were not deemed material to the consolidated financial statements.

On May 29, 2013, our wholly owned subsidiary, RCI Entertainment (Delamo), Inc., completed the acquisition of the remaining 50 % of 1957 Delamo, LLC, which owns a new adult cabaret in Los Angeles County, California. We issued 100,000 restricted shares of our common stock to an individual in consideration for outstanding membership interests of 1957 Delamo, LLC. These shares were valued at $863,000. The Company had previously paid $600,000 in cash for the initial 50 % investment.

The following information summarizes the allocation of fair values assigned to the assets at the purchase date. (in thousands)

Furniture and equipment	$200
SOB licenses	1,263
Net assets	$1,463

The Company incurred approximately $7,000 in legal costs associated with the acquisition, which are included in legal and professional expense in the accompanying consolidated statement of income.

10. INCOME TAXES

Income tax expense on continuing operations for the periods presented differs from the “expected” federal income tax expense computed by applying the U.S. federal statutory rate of 34% to earnings before income taxes for the three months ended December 31, as a result of the following:

	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
	2014	2013	2014	2013
Computed expected tax expense	$283	$1,221	$3,428	$4,175
State income taxes	76	72	181	110
Stock option disqualifying dispositions and other permanent differences	(156)	50	(161)	248
Total income tax expense	$203	$1,343	$3,448	$4,533

Included in the Company’s deferred tax liabilities at June 30, 2014 is approximately $17.2 million representing the tax effect of indefinite lived intangible assets from club acquisitions which are not deductible for tax purposes. These deferred tax liabilities will remain in the Company’s balance sheet until the related clubs are sold.

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11. COMMITMENTS AND CONTINGENCIES

Legal Matters

Beginning January 1, 2008, the Company's Texas clubs became subject to a new state law requiring each club to collect and pay a $5 surcharge for every club visitor. A lawsuit was filed by the Texas Entertainment Association ("TEA"), an organization to which the Company is a member, alleging the fee amounts to be an unconstitutional tax. On March 28, 2008, a State District Court Judge in Travis County, Texas ruled that the new state law violates the First Amendment to the United States Constitution and is therefore invalid. The judge's order enjoined the State from collecting or assessing the tax. The State appealed the Court's ruling. In Texas, when cities or the State give notice of appeal, it supersedes and suspends the judgment, including the injunction. Therefore, the judgment of the District Court cannot be enforced until the appeals are completed. Given the suspension of the judgment, the State gave notice of its right to collect the tax pending the outcome of its appeal but took no affirmative action to enforce that right. On June 5, 2009, the Court of Appeals for the Third District (Austin) affirmed the District Court's judgment that the Sexually Oriented Business ("S.O.B.") Fee violated the First Amendment to the U.S. Constitution but on August 26, 2011, the Texas Supreme Court reversed the judgment of the Court of Appeals, ruling that the SOB Fee does not violate the First Amendment to the U.S. Constitution, and remanded the case to the District Court to determine whether the fee violates the Texas Constitution.

TEA appealed the Texas Supreme Court's decision to the U.S. Supreme Court (regarding the constitutionality of the fee under the First Amendment of the U.S. Constitution), but the U.S. Supreme Court denied the appeal on January 23, 2012. Subsequently, the case was remanded to the District Court for consideration of the remaining issues raised by TEA. On June 28, 2012, the District Court in Travis County held a hearing on TEA's Texas Constitutional claims and on July 9, 2012 entered an order finding that the tax was a constitutional Occupations Tax. The Court denied the remainder of TEA's constitutional claims. TEA appealed the trial court's ruling to the Third Court of Appeals and on May 9, 2014, the Third Court of Appeals issues a ruling adverse to TEA and in favor of the State. TEA filed a petition for review to the Texas Supreme Court on July 17, 2014, and is awaiting a decision by the court.

The Company has not made any payments of these taxes since the first quarter of 2009 and plans not to make any such payments while the case is pending in the courts. However, the Company will continue to accrue and expense the potential tax liability on its financial statements, so any ultimate negative ruling will not have any effect on its consolidated income statement and will only affect the consolidated balance sheet. If the final decision of the courts is ultimately in the Company's favor, as it believes it will be, then the Company will record a one-time gain of the entire amount previously expensed.

Since the inception of the tax, the Company has paid more than $2 million to the State of Texas under protest for all four quarters of 2008 and the first quarter of 2009, expensing it in the consolidated financial statements (except for two locations in Dallas where the taxes have not been paid, but the Company is accruing and expensing the liability). For all subsequent quarters, as a result of the Third Court's 2009 decision, the Company has accrued the tax, but not paid the State. Accordingly, as of June 30, 2014, the Company has approximately $15.4 million in accrued liabilities for this tax. Patron tax expense amounted to approximately $765,000 and $746,000 for the quarters ended June 30, 2014 and 2013, respectively. The Company's Texas clubs have filed a separate lawsuit against the State in which the Company raises additional challenges to the statute imposing the fee or tax, demanding repayment of the taxes the Company has paid under this statute. The courts have not yet addressed these additional claims. If the Company is successful in the remaining litigation, the amount the Company has paid under protest should be repaid or applied to any future, constitutional admission tax or other Texas state tax liabilities.

The Company's subsidiary that operated the club in Las Vegas has recently been audited by the Department of Taxation of the State of Nevada for sales and other taxes. The audit period was from the date of opening in September 2008 through July 31, 2010. As a result of the audit, the Department of Taxation contends that the Company's Las Vegas subsidiary owes approximately $2.1 million, including penalties and interest, for Las Vegas Live Entertainment Taxes. The Company does not believe it was subject to the Live Entertainment Tax, but to

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11. COMMITMENTS AND CONTINGENCIES - continued

avoid further litigation, agreed to settle this contingency during July 2014 for $775,000. This amount has been accrued as a liability and expensed in settlement of lawsuits and other one-time costs in the accompanying consolidated financial statements as of June 30, 2014.

The Company and subsidiaries RCI Entertainment (New York), Inc. (“RCI NY”) and Peregrine Enterprises, Inc. (“Peregrine”) have been defendants in a federal court action, pending since March 30, 2009, in the Southern District of New York relating to claims under the Fair Labor Standards Act and New York’s wage and hour laws. While Plaintiffs do not specifically allege the amount of monetary relief sought in their Complaint, Plaintiffs have alleged that they are seeking judgment equal to any unpaid wages, liquidated damages, interest, costs and attorneys’ fees pursuant to the FLSA and New York Labor Law. The Company, RCI NY and Peregrine deny liability in this matter, are vigorously defending the allegations and have asserted counterclaims and affirmative defenses for offset and unjust enrichment. Discovery is now complete and on September 10, 2013, the court ruled on the parties’ motions for summary judgment. The court granted summary judgment in favor of the Plaintiffs on their causes of action for minimum wage and held that entertainers at RCI NY are employees, that Peregrine was an employer of the Plaintiffs and that under federal law, RCI NY’s statutory duty to pay minimum wages was not satisfied by the performance fees Plaintiffs’ received. The court has not yet ruled on whether performance fees can offset minimum wages under New York state law. The court denied the Plaintiffs’ attempt to hold the Company or RCI NY liable as joint employers with Peregrine and the issue of whether the Company and RCI NY are also employers will be determined at a trial. Ultimately, the Company, RCI NY and Peregrine intend to appeal the summary judgment ruling. The Company has moved to decertify the Rule 23 class and the FLSA collective, which motion is presently pending before the court.

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 be filed with the Receiver before the close of business on January 16, 2015 and that all pending lawsuits involving IIC as the insurer are further stayed or abated until October 7, 2014. As a result, the Company and its subsidiaries no longer have insurance coverage under the liability policy with IIC. Currently, there are multiple civil lawsuits pending or threatened against the Company and its subsidiaries; and other potential lawsuits for incidents that occurred before October 25, 2013 could still be filed. The Company has retained counsel to defend against and evaluate these claims and lawsuits. The Company also plans to file the appropriate claims against IIC with the Receiver by the January 16, 2015 deadline; 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, the Company has obtained general liability coverage from another insurer, effective October 25, 2013, which will cover any claims arising from actions after that date.

Settlement of lawsuits and other one-time costs include a $2 million settlement with a claimant which was unpaid by our general liability insurance carrier. We will be filing a claim with the insurance company's estate and with the state's insurance fund for this settlement.

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12. ASSETS HELD FOR SALE

Assets held for sale represent two items at June 30, 2014: Land and building in Beaumont, Texas and an aircraft. Each of these assets is under contract for sale as of June 30, 2014. These assets are carried at the lower of their carrying value or fair value, less cost to sell.

13. WARRANTS ISSUED

In February 2014, the Company issued warrants to acquire 100,000 shares of Company common shares to a financial adviser. The exercise price of the warrants was $11.77, the market price of the shares at the time. The warrants were exercisable immediately and expire in two years. The fair value of the warrants, which was entirely charged to expense upon issuance, was estimated to be $147,683 in accordance with FASB ASC 820, *Fair Value Measurements*, using a Black-Scholes option-pricing model using the following weighted average assumptions:

Volatility	31.5	%
Expected life	1.0 years	
Expected dividend yield	-	
Risk free rate	.12	%

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with our audited consolidated financial statements and related notes thereto included in this quarterly report.

GENERAL

RCI Hospitality Holdings, Inc. (formerly Rick's Cabaret International, Inc.) was incorporated in the State of Texas in 1994. Through our subsidiaries, as of June 30, 2014, we operate a total of forty-three establishments that offer live adult entertainment, and/or restaurant and bar operations. We have one reportable segment, nightclubs.

SCHEDULE OF ESTABLISHMENTS

Name of Nightclub	Date 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 North, Houston, TX	2004
Rick's Cabaret, New York City, NY	2005
Club Onyx, Charlotte, NC	2005
Rick's Cabaret, San Antonio, TX	2006
XTC Cabaret South, South Houston, TX	2006
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, North Austin, TX	2009
Cabaret North, Fort Worth, TX	2009
Cabaret East, Fort Worth, TX	2010
XTC Cabaret, Fort Worth, TX	2010
Rick's Cabaret DFW, Fort Worth, TX	2011
Downtown Cabaret, Minneapolis, MN	2011
Rick's Cabaret, Indianapolis, IN	2011
Temptations, Aledo, TX	2011
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
Rick's Cabaret, Lubbock, TX	2012
Jaguar's Club, Beaumont, TX	2012
Rick's Cabaret, Odessa, TX (1)	2012
Vee Lounge, Fort Worth, TX	2013
Bombshells, Dallas, TX	2013
Ricky Bobby Sport Saloon, Fort Worth, TX	2013
Temptations, Sulphur, LA	2013
Temptations, Beaumont, TX	2013
Vivid Cabaret, Los Angeles, CA	2013
The Black Orchid, Dallas, TX	2013
Vivid Cabaret, New York, NY	2014
Jaguars, Houston, TX (Closed temporarily)	2013
Bombshells, Austin, TX	2014
Bombshells, Webster, TX	2014
Bombshells, Fuqua (Houston) TX (1)	2014
Bombshells, Spring, TX (1)	2014

(1) To be opened in Calendar 2014.

As noted above, we have the following nightclubs/restaurant under construction or contract:

- Rick's Cabaret Odessa, Texas – under construction – opening in summer of 2014.
- Bombshells, Fuqua (Houston) to be opened in summer of 2014.
- Bombshells, Spring, Texas to be opened in fall of 2014.

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-Q.

CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles of the United States of America ("GAAP"). GAAP consists of a set of standards issued by the FASB and other authoritative bodies in the form of FASB Statements, Interpretations, FASB Staff Positions, Emerging Issues Task Force consensuses and American Institute of Certified Public Accountants Statements of Position, among others. The Company has updated references to GAAP in this Form 10-Q to reflect the guidance in the ASC. The preparation of these consolidated financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On a regular basis, we evaluate these estimates, including investment impairment. These estimates are based on management's historical industry experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

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, equipment and leasehold improvements have estimated useful lives between five and 40 years. 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 or abandoned and the related accumulated depreciation are eliminated from the accounts and any gains or losses are charged or credited in the accompanying consolidated statement of income of the respective period.

Goodwill and Intangible Assets

FASB ASC 350, *Goodwill and Other Intangibles Assets* addresses the accounting for goodwill and other intangible assets. Under FASB ASC 350, goodwill and intangible assets with indefinite lives are no longer amortized, but reviewed on an annual basis for impairment. Definite lived intangible assets are amortized on a straight-line basis over their estimated lives. Fully amortized assets are written-off against accumulated amortization.

Impairment of Long-Lived Assets

In accordance with ASC 205, long-lived assets, such as property, plant, and equipment, and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be 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. The assets and liabilities of a disposal group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired in accordance with ASC 350. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value.

For goodwill, the impairment determination is made at the reporting unit level. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

None of our reporting units were at risk of failing step one of the impairment test (i.e. that fair value was not substantially in excess of carrying value) in either year.

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 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.

Revenue Recognition

The Company recognizes revenue from the sale of alcoholic beverages, food and merchandise, other revenues and services at the point-of-sale upon receipt of cash, check, or credit card charge.

The Company recognizes Internet revenue from monthly subscriptions to its online entertainment sites when notification of a new or existing subscription and its related fee are received from the third party hosting company or from the credit card company, usually two to three days after the transaction has occurred. The monthly fee is not refundable. The Company recognizes Internet auction revenue when payment is received from the credit card as revenues are not deemed estimable nor collection deemed probable prior to that point.

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 in August.

Income Taxes

Deferred income taxes are determined using the liability method in accordance with FASB ASC 740, *Accounting for Income Taxe*s. 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.

FASB ASC 740 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. FASB ASC 740 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. There are no unrecognized tax benefits to disclose in the notes to the consolidated financial statements.

Put Options

In certain situations, the Company issues restricted common shares as partial consideration for acquisitions of certain businesses or assets. Pursuant to the terms and conditions of the governing acquisition agreements, the holder of such shares has the right, but not the obligation, to put a fixed number of the shares on a monthly basis back to the Company at a fixed price per share. The Company may elect during any given month to either buy the monthly shares or, if management elects not to do so, the holder can sell the monthly shares in the open market, and any deficiency between the amount which the holder receives from the sale of the monthly shares and the value of shares will be paid by the Company. The Company has accounted for these shares in accordance with the guidance established by FASB ASC 480, *Distinguishing Liabilities From Equity,* as a reclassification of the value of the shares from permanent to temporary equity. As the shares become due, the Company transfers the value of the shares back to permanent equity, less any amount paid to the holder. Also see “Derivative Financial Instruments” above. We finished liquidating these put options during the quarter ended March 31, 2013.

Earnings Per Common Share

The Company computes earnings per share in accordance with FASB ASC 260, *Earnings Per Share*. FASB ASC 260 provides for the calculation of basic and diluted earnings per 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 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 EPS considers the potential dilution that could occur if the Company’s outstanding common stock options, warrants and convertible debentures were converted into common stock that then shared in the Company’s earnings (as adjusted for interest expense, that would no longer occur if the debentures were converted).

Stock Options

The compensation cost recognized for the three months ended June 30, 2014 and 2013 was $2,922 and $281,745, respectively. There were 269,665 stock options exercised during the quarter ended June 30, 2014, aggregating $2,281,803. There were no stock options exercises for the three months ended June 30, 2013.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2014 AS COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2013

For the three months ended June 30, 2014, we had consolidated total revenues of $33.3 million compared to consolidated total revenues of $28.3 million for the three months ended June 30, 2013, an increase of $5.0 million or 17.8%. The increase in total revenues was primarily attributable to clubs acquired during the last year with a 5.1% increase in same-store sales. Total revenues for same-location-same-period of club operations increased to $28.9 million for the three months ended June 30, 2014 from $27.5 million for the same period ended June 30, 2013, a 5.1% increase. Nearly all of the major brands showed year over year improvement, with the primary exception of the Club Onyx units. New Club Onyx format and management changes, however, have significantly reduced the percentage year over year revenue decline compared to the previous quarter. Excluding these units, same store sales would have been up 6.9%.

Following is a comparison of the Company's income statement for the quarters ended June 30, 2014 and 2013 with percentages compared to total revenue:

(in thousands)	2014	%	2013	%
Sales of alcoholic beverages	$13,626	40.9 %	$11,105	39.2 %
Sales of food and merchandise	4,076	12.2 %	3,288	11.6 %
Service Revenues	14,035	42.1 %	12,382	43.7 %
Other	1,606	4.8 %	1,533	5.4 %
Total Revenues	33,343	100.0%	28,308	100.0%
Cost of Goods Sold	4,295	12.9 %	3,680	13.0 %
Salaries & Wages	7,219	21.7 %	6,413	22.7 %
Stock-based Compensation	2	0.0 %	282	1.0 %
Taxes and permits	5,150	15.4 %	4,302	15.2 %
Charge card fees	479	1.4 %	409	1.4 %
Rent	1,315	3.9 %	846	3.0 %
Legal & professional	1,186	3.6 %	797	2.8 %
Advertising and marketing	1,420	4.3 %	1,187	4.2 %
Insurance	1,014	3.0 %	573	2.0 %
Utilities	650	1.9 %	523	1.8 %
Depreciation and amortization	1,532	4.6 %	1,341	4.7 %
Gain on sale of property	334	1.0 %	-	0.0 %
Settlement of lawsuits and other one-time costs	3,253	9.8 %	160	0.6 %
Other	2,602	7.8 %	2,335	8.2 %
Total operating expenses	30,451	91.3 %	22,848	80.7 %
Operating income	2,892	8.7 %	5,460	19.3 %
Interest income	-	0.0 %	(2)	0.0 %
Interest expense	(2,060)	-6.2 %	(1,868)	-6.6 %
Gain (loss) on change in fair value of derivative instruments	-	0.0 %	1	0.0 %
Income from continuing operations before income taxes	$832	2.5 %	$3,591	12.7 %

Following is an explanation of significant variances in the above amounts.

Service revenues include cover charges, fees paid by entertainers, room rentals, memberships and fees charged for credit card processing. Other revenues include ATM commissions earned, video games and other vending and certain promotion fees charged to our entertainers. We recognize revenue from other revenues and services at the point-of-sale upon receipt of cash, check, or credit card charge.

Cost of goods sold includes cost of alcoholic and non-alcoholic beverages, food, cigars and cigarettes, merchandise, media printing/binding and media postage. The cost of goods sold for the club operations was 12.7% and 13.0% for the three months ended June 30, 2014 and 2013, respectively. The cost of goods sold for same-location-same-period of club operations for the three months ended June 30, 2014 was 12.2%, compared to 12.9% for the same period ended June 30, 2013.

Payroll for same-location-same-period of club operations was $5.0 million for the three months ended June 30, 2014 and $5.2 million for the same period in 2013. The decrease is due to adjustments and reduction of payroll in certain locations. Management currently believes that its labor and management staff levels are appropriate.

The increase in the percentage of rent expense to revenues is due to increased rents in both of our New York clubs, our Los Angeles club and our restaurants opening in leased locations.

The increase in legal and professional expense is principally due to a continuing labor lawsuit in New York which was more active in the 2014 quarter and due to general increase in legal fees as a result of our general liability insurance company bankruptcy. Also see Note 11 of Notes to Consolidated Financial Statements for more information regarding our former general liability insurer.

The increase in insurance expense is due to an increase from acquisitions and an increase in premium rates, especially in the general liability area. Also see Note 11 of Notes to Consolidated Financial Statements for more information regarding our former general liability insurer.

Settlement of lawsuits and other one-time costs include a $2 million settlement with a claimant which was unpaid by our general liability insurance carrier. We will be filing a claim with the insurance company's estate and with the state's insurance fund for this settlement. Also included is $775,000 to settle a previously-disclosed claim by the state of Nevada for $2.1 million in Live Entertainment Tax. The Company does not believe it was subject to the Live Entertainment Tax, but to avoid further litigation, agreed to settle this contingency during July 2014. This amount has been accrued as a liability as of June 30, 2014.

Income taxes, as a percentage of income before taxes was 24.4% and 37.3% for the quarters ended June 30, 2014 and 2013, respectively. The decrease in 2014 is principally due to the tax deductions from exercised stock options in 2014.

Operating income (exclusive of corporate overhead) for same-location-same-period of club operations was $6.8 million for each of the quarters ended June 30, 2014 and 2013. The 2014 period was affected by losses in the period amounting to over $306,000 as a result of pre-opening costs for the Company's unopened Bombshells compared to only $185,000 in pre-opening costs for the previous year.

Our "operating margin", the percentage of operating income to total revenues, was 8.7% and 19.3% for the quarters ended June 30, 2014 and 2013, respectively. The decrease is principally due to the one-time costs and preopening costs in 2014.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED JUNE 30, 2014 AS COMPARED TO THE NINE MONTHS ENDED JUNE 30, 2013

For the nine months ended June 30, 2014, we had consolidated total revenues of $95.6 million compared to consolidated total revenues of $84.2 million for the nine months ended June 30, 2013, an increase of $11.5 million or 13.6%.

Following is a comparison of the Company's income statement for the nine months ended June 30, 2014 and 2013 with percentages compared to total revenue:

(in thousands)	2014	%	2013	%
Sales of alcoholic beverages	$38,300	40.0 %	$32,554	38.7 %
Sales of food and merchandise	11,478	12.0 %	8,744	10.4 %
Service Revenues	41,112	43.0 %	38,089	45.2 %
Other	4,746	5.0 %	4,790	5.7 %
Total Revenues	95,636	100.0%	84,177	100.0%
Cost of Goods Sold	12,083	12.6 %	10,561	12.5 %
Salaries & Wages	20,650	21.6 %	18,600	22.1 %
Stock-based Compensation	156	0.2 %	845	1.0 %
Taxes and permits	14,707	15.4 %	13,069	15.5 %
Charge card fees	1,356	1.4 %	1,126	1.3 %
Rent	3,699	3.9 %	2,199	2.6 %
Legal & professional	2,400	2.5 %	2,454	2.9 %
Advertising and marketing	4,111	4.3 %	3,452	4.1 %
Insurance	2,785	2.9 %	1,642	2.0 %
Utilities	1,891	2.0 %	1,564	1.9 %
Depreciation and amortization	4,438	4.6 %	3,987	4.7 %
Gain on sale of property	248	0.3 %	-	0.0 %
Settlement of lawsuit	3,523	3.7 %	160	0.2 %
Other	7,624	8.0 %	6,973	8.3 %
Total operating expenses	79,671	83.3 %	66,632	79.2 %
Operating income	15,965	16.7 %	17,545	20.8 %
Interest income	112	0.1 %	6	0.0 %
Interest expense	(5,996)	-6.3 %	(5,274)	-6.3 %
Gain (loss) on change in fair value of derivative instruments	-	0.0 %	2	0.0 %
Income from continuing operations before income taxes	$10,081	10.5 %	$12,279	14.6 %

Following is an explanation of significant variances in the above amounts.

Service revenues include cover charges, fees paid by entertainers, room rentals, memberships and fees charged for credit card processing. Other revenues include ATM commissions earned, video games and other vending and certain promotion fees charged to our entertainers. We recognize revenue from other revenues and services at the point-of-sale upon receipt of cash, check, or credit card charge.

Cost of goods sold includes cost of alcoholic and non-alcoholic beverages, food, cigars and cigarettes, merchandise, media printing/binding, media postage and internet traffic purchases and webmaster payouts. The cost of goods sold for the club operations for the nine months ended June 30, 2014 was 12.5% for each of the nine months ended June 30, 2014 and 2013. The cost of goods sold for same-location-same-period of club operations for the nine months ended June 30, 2014 was 11.6%, compared to 12.1% for the same period ended June 30, 2013.

Payroll for same-location-same-period of club operations was $13.7 million for the nine months ended June 30, 2014 and $14.5 million for the same period in 2013. The decrease is due to adjustments and reduction of payroll in certain locations. Management currently believes that its labor and management staff levels are appropriate.

The decrease in stock-based compensation is due to the stock options to employees and Board members in 2012 completely vesting in 2013.

The increase in the percentage of rent expense to revenues is due to increased rents in both of our New York clubs, our Los Angeles club and our opening restaurants in leased locations.

The decrease in legal and professional expense is principally due to a continuing labor lawsuit in New York which was more active in the first six months of the 2013 period.

The increase in insurance expense is due to an increase from acquisitions and an increase in premium rates, especially in the general liability area. Also see Note 11 of Notes to Consolidated Financial Statements for more information regarding our former general liability insurer.

The increase in depreciation is principally due to the new clubs acquired.

Settlement of lawsuits and other one-time costs include a $2 million settlement with a claimant which was unpaid by our general liability insurance carrier. We will be filing a claim with the insurance company's estate and with the state's insurance fund for this settlement. Also included is $775,000 to settle a previously-disclosed claim by the state of Nevada for $2.1 million in Live Entertainment Tax. The Company does not believe it was subject to the Live Entertainment Tax, but to avoid further litigation, agreed to settle this contingency during July 2014. This amount has been accrued as a liability as of June 30, 2014.

Income taxes, as a percentage of income before taxes was 34.2% and 36.9% for the nine months ended June 30, 2014 and 2013, respectively. The lower rate in 2014 is principally due to the tax deductions from exercised stock options in 2014, less the increased stock-based compensation in 2013, which is not deductible for tax purposes.

Operating income (exclusive of corporate overhead) for same-location-same-period of club operations decreased to $21.1 million for the nine months ended June 30, 2014 from to $21.8 million for same period ended June 30, 2013, or by 3.1%. The 2014 period was affected by losses in the period amounting to over $743,000 as a result of pre-opening costs for the Company's unopened Bombshells and Vivid New York compared to only $393,000 in pre-opening costs for the previous year.

Our "operating margin", the percentage of operating income to total revenues, was 16.7% and 20.8% for the nine months ended June 30, 2014 and 2013, respectively. The decrease is principally due to the one-time costs in 2014.

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 some recurring charges that are included in 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, patron taxes, pre-opening costs, gains and losses from asset sales, stock-based compensation charges, litigation and other one-time legal settlements and acquisition costs. 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 Basic Share and per Diluted Share. We exclude from non-GAAP net income and non-GAAP net income per diluted share and per basic share amortization of intangibles, patron taxes, pre-opening costs, income tax expense, impairment charges, gains and losses from asset sales, stock-based compensation, litigation and other one-time legal settlements and acquisition costs, and include the Non-GAAP provision for income taxes, calculated as the tax-effect at 35% effective tax rate of the pre-tax non-GAAP

income before taxes less stock-based compensation, because we believe that excluding such measures helps management and investors better understand our operating activities.

Adjusted EBITDA. We exclude from Adjusted EBITDA depreciation expense, amortization of intangibles, income tax, interest expense, interest income, gains and losses from asset sales, acquisition costs, litigation and other one-time legal settlements and impairment charges because we believe that adjusting for such items helps management and investors better understand 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. Also, we exclude interest cost in our calculation of Adjusted EBITDA. The results are, therefore, without consideration of financing alternatives of capital employed. We use Adjusted EBITDA as one guideline to assess our unleveraged performance return on our investments. Adjusted EBITDA is also the target benchmark for our acquisitions of nightclubs.

The following tables present our non-GAAP measures for the periods ended June 30, 2014 and 2013 (in thousands, except per share amounts):

	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
(in thousands)	2014	2013	2014	2013
Reconciliation of GAAP net income to Adjusted EBITDA				
GAAP net income	$691	$2,195	$6,816	$7,587
Income tax expense	203	1,343	3,448	4,533
Interest expense and income and gain on derivative	2,060	1,867	5,884	5,266
Litigation and other one-time legal settlements	3,233	160	3,503	160
Acquisition costs	22	30	111	119
Depreciation and amortization	1,532	1,341	4,438	3,987
Adjusted EBITDA	$7,741	$6,936	$24,200	$21,652
Reconcilation of GAAP net income to non-GAAP net income				
GAAP net income	$691	$2,195	$6,816	$7,587
Patron tax	765	746	2,370	2,536
Amortization of intangibles	82	92	254	322
(Gain) loss on change in fair value of derivative instruments	-	(1)	-	(2)
Stock-based compensation	2	282	156	845
Litigation and other one-time settlements	3,233	160	3,503	160
Pre-opening costs	306	185	743	393
Income tax expense	203	1,343	3,448	4,533
Acquisition costs	22	30	111	119
Non-GAAP provision for income taxes	(1,856)	(1,663)	(6,036)	(5,477)
Non-GAAP net income	$3,448	$3,369	$11,365	$11,016
Reconciliation of GAAP diluted net income per share to non-GAAP diluted net income per share				
Fully diluted shares	9,968	9,647	9,922	9,871
GAAP net income	$0.07	$0.23	$0.69	$0.79
Patron tax	0.08	0.08	0.24	0.26
Amortization of intangibles	0.01	0.01	0.03	0.03
(Gain) loss on change in fair value of derivative instruments	-	(0.00)	-	(0.00)
Stock-based compensation	0.00	0.03	0.02	0.09
Litigation and other one-time settlements	0.32	0.02	0.35	0.02
Pre-opening costs	0.03	0.02	0.07	0.04
Income tax expense	0.02	0.14	0.35	0.46
Acquisition costs	0.00	0.00	0.01	0.01
Non-GAAP provision for income taxes	(0.19)	(0.17)	(0.61)	(0.55)
Non-GAAP diluted net income per share	$0.35	$0.36	$1.15	$1.13

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Reconciliation of GAAP operating income to non-GAAP operating income				
GAAP operating income	$2,892	$5,460	$15,965	$17,545
Patron tax	765	746	2,370	2,536
Amortization of intangibles	82	92	254	322
Stock-based compensation	2	282	156	845
Litigation and other one-time settlements	3,233	160	3,503	160
Pre-opening costs	306	185	743	393
Acquisition costs	22	30	111	119
Non-GAAP operating income	$7,302	$6,955	$23,102	$21,920

Reconciliation of GAAP operating margin to non-GAAP operating margin								
GAAP operating income	8.7	%	19.3	%	16.7	%	20.8	%
Patron tax	2.3	%	2.6	%	2.5	%	3.0	%
Amortization of intangibles	0.2	%	0.3	%	0.3	%	0.4	%
Stock-based compensation	0.0	%	1.0	%	0.2	%	1.0	%
Litigation and other one-time settlements	9.7	%	0.6	%	3.7	%	0.2	%
Pre-opening costs	0.9	%	0.7	%	0.8	%	0.5	%
Acquisition costs	0.1	%	0.1	%	0.1	%	0.1	%
Non-GAAP operating margin	21.9	%	24.6	%	24.2	%	26.0	%

LIQUIDITY AND CAPITAL RESOURCES

We believe our ability to generate cash from operating activities is one of our fundamental financial strengths. Refer to the heading "Cash Flows from Operating Activities" below. The near-term outlook for our business remains strong, and we expect to generate substantial cash flows from operations in 2014. 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 shareowners' equity. Refer to the heading "Cash Flows from Financing Activities" below. 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 have historically utilized these cash flows to invest in property and equipment and adult nightclubs. Refer to the heading “Cash Flows from Investing Activities” below.

As of June 30, 2014, excluding the patron tax liability, we had working capital of $5.2 million compared to working capital of $4.8 million as of September 30, 2013. As much of this current portion of debt is convertible debt, it is anticipated that it will be redeemed with common shares. Because of the large volume of cash we handle, stringent cash controls have been implemented. At June 30, 2014, our cash and cash equivalents were $11.1 million compared to $10.6 million at September 30, 2013.

Our depreciation for the quarter ended June 30, 2014 was $1.4 million compared to $1.2 million for the quarter ended June 30, 2013. Our amortization for the quarter ended June 30, 2014 was $82,000 compared to $92,000 for the quarter ended June 30, 2013.

Sources and Use of Funds

Cash flows from operating activities are generally the result of net income adjusted for depreciation and amortization expenses, deferred taxes, (increases) decreases in accounts receivable, inventories and prepaid expenses and increases (decreases) in accounts payable and accrued liabilities. See a summary of these activities below.

Cash flows used in investing activities generally reflect payments relating to acquisitions of businesses, property and equipment and marketable securities. See a summary of these activities below.

Cash flows from financing activities generally reflect proceeds from issuance of shares and long-term debt, and payments on debt and put options and purchase of treasury stock. See a summary of these activities below.

Cash Flows from Operating Activities

Following are our summarized cash flows from operating activities:

(in thousands)	Nine Months Ended June 30,	
	2014	2013
Net income	$6,633	$7,746
Depreciation and amortization	4,438	3,988
Deferred taxes	225	(103)
Stock compensation expense	156	845
Change in operating assets and liabilities	2,050	1,570
Other	296	99
	$13,798	$14,145

Cash Flows from Investing Activities

Following are our summarized cash flows from investing activities:

(in thousands)	Nine Months Ended June 30,	
	2014	2013
Proceeds from sale of marketable securities and other assets	$223	$500
Acquisition of development rights in New York Building	(5,325)	-
Additions to property and equipment	(11,822)	(5,497)
Additions of businesses, net of cash acquired	(500)	(3,645)
	$(17,424)	$(8,642)

Following is a reconciliation of our additions to property and equipment for the nine months ended June 30, 2014 and 2013:

(in thousands)	Nine Months ended June 30,	
	2014	2013
Acquisition of real estate	$3,103	$15,694
Capital expenditures funded by debt	(4,879)	(13,561)
New capital expenditure in new clubs and purchase of aircraft	12,188	2,448
Maintenance capital expenditures	1,410	916
Total capital expenditures in consolidated statement of cash flows	$11,822	$5,497

Cash Flows from Financing Activities

Following are our summarized cash flows from financing activities:

(in thousands)	Nine Months Ended June 30,	
	2014	2013
Proceeds from long-term debt	$7,025	$7,000
Purchase of put options and payments on derivative	-	(139)
Payments on long-term debt	(5,899)	(7,219)
Purchase of treasury stock	-	(1,478)
Exercise of stock options	3,126	-
Distribution of minority interests	(162)	(162)
	$4,090	$(1,998)

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

(in thousands)	Nine Months Ended June 30,	
	2014	2013
Operating activities	$13,798	$14,145
Investing activities	(17,424)	(8,642)
Financing activities	4,090	(1,998)
Net increase (decrease) in cash	$464	$3,505

Other than the potential loss of the Patron Tax issue with the State of Texas (see Note 11 of Notes to Consolidated Financial Statements) we are not aware of any other event or trend that would potentially 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. We also believe that, in the event of loss of the Patron Tax issue, the State of Texas would waive any penalties and allow us to pay out any liability over a reasonable amount of time. 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 for the nine months ended June 30:

	2014	Increase (Decrease)		2013
(in thousands)				
Sales of alcoholic beverages	$38,300	17.7	%	$32,554
Sales of food and merchandise	11,478	31.3	%	8,744
Service Revenues	41,112	7.9	%	38,089
Other	4,746	-0.9	%	4,790
Total Revenues	$95,636	13.6	%	$84,177
Net cash provided by operating activities	13,798	-2.5	%	14,145
Adjusted EBITDA*	24,200	11.7	%	21,652
Long-term debt	82,383	4.8	%	78,592

* See definition of adjusted EBITDA above under Results of Operations.

Share repurchase

On September 29, 2008, our Board of Directors authorized us to repurchase up to $5 million worth of our common stock in the open market. As of April 2013, we completed the repurchase of all $5 million in stock authorized under this plan. On April 25, 2013, our Board of Directors authorized us to repurchase up to an additional $3 million worth of our common stock in the open market or in privately negotiated transactions. During May 2014, our Board of Directors increased the repurchase authorization to $10 million. During the quarter ended June 30, 2014, we did not purchase any shares of common stock in the open market. Under the Board's authority, we have $10 million remaining to purchase additional shares as of June 30, 2014.

Other Liquidity and Capital Resources

We have not established lines of credit or financing other than the notes payable and our existing debt. 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.

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 sexually oriented business industry is required in all states to convert dancers who are now independent contractors into employees.

The sexually oriented business industry is highly competitive with respect to price, service and location, as well as the professionalism of the entertainment. Although management believes that we are well-positioned to compete successfully in the future, there can be no assurance that we will be able to maintain our high level of name recognition and prestige within the marketplace.

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 with the strongest operating results occurring during October through March.

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 is: (a) to open new clubs after market analysis, (b) to acquire existing clubs in locations that are consistent with our growth and income targets and which appear receptive to the upscale club formula we have developed, (c) 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, (d) to develop new club concepts that are consistent with our management and marketing skills, (e) to develop and open our sports bar and restaurant concepts as our capital and manpower allow, and/or (f) to control the real estate in connection with club operations, although some clubs may be in leased premises.

During fiscal 2010, we acquired three existing nightclub operations for a total cost of approximately $9.2 million, including real property of approximately $4.6 million. These acquisitions were funded primarily with cash of approximately $5.9 million, real property debt of approximately $2.5 million, and a seller's common stock which we owned, valued at approximately $795,000. These nightclub operations had total revenues of approximately $7.5 million, $8.6 million and $7.3 million and net income before taxes of approximately $1.3 million, $932,000 and $609,000 for fiscal years 2013, 2012 and 2011, respectively.

During fiscal 2011, we acquired three existing nightclub operations and opened another for a total cost of approximately $11.3 million, including real property of approximately $6.4 million. These acquisitions were funded with cash. These nightclub operations had total revenues of approximately $6.8 million and $5.6 million and net income before taxes of approximately $1.4 million and $500,000 for the fiscal years 2013 and 2012, respectively.

During fiscal 2012, we acquired eleven existing nightclub operations and two other licensed locations under development for a total cost of approximately $35.4 million, including real property of approximately $7.6 million. These acquisitions were funded primarily with cash of approximately $4.9 million, debt of $22 million and real property debt of approximately $9.0 million. These nightclub operations had total revenues of approximately $18.5 million and $4.3 million and net income before taxes of approximately $2.9 million and $620,000 for fiscal years 2013 and 2012, respectively. These amounts do not include the acquisition of approximately $10.1 million of real estate relating to the Jaguars acquisition (see Note 9 of Notes to Consolidated Financial Statements) which was closed on October 16, 2012.

During fiscal 2013, in addition to the real estate explained in the previous paragraph, we have acquired an existing licensed location for $3,000,000 ($1.5 million in cash and the balance in promissory notes). This location was remodeled and opened in January 2014. We also acquired the remaining 50% of an unopened club for $863,000 of common stock in May 2013. We also acquired another club for $300,000 in cash. We previously had acquired the real estate for this location.

In October 2013, the Company purchased 49 percent of a corporation that operates the Dallas club "PT's Platinum" and also acquired the building and personal property. Total cost of the transaction was $500,000.

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 will require us to obtain additional debt or issuance of 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.

In addition to their strong cash flow, the acquisition of the Media Division has enabled us to create new marketing synergies with major industry product suppliers and new national advertising opportunities. It also provides us with additional diversification of our revenue and income streams while remaining within our core competency.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As of June 30, 2014, there were no material changes to the information provided in Item 7A of the Company's Annual Report on Form 10-K for fiscal year ended September 30, 2013.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of the Company's senior management, including the Company's chief executive officer and chief financial officer, the Company conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this quarterly report (the "Evaluation Date"). Based on this evaluation, the Company's chief executive officer and chief financial officer concluded as of the Evaluation Date that the Company's disclosure controls and procedures were effective such that the information relating to the Company, including consolidated subsidiaries, required to be disclosed in the Company's Securities and Exchange Commission ("SEC") reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including the Company's chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2014 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

See "Legal Matters" under Note 11 of Notes to Consolidated Financial Statements above, which information is incorporated herein by reference.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended September 30, 2013, as such factors could materially affect the Company’s business, financial condition or future results. In the three months ended June 30, 2014, there were no material changes to the risk factors disclosed in the Company’s 2013 Annual Report on Form 10-K. The risks described in the Annual Report on Form 10-K are not the only risks the Company faces. Additional risks and uncertainties not currently known to the Company, or that the Company deems to be immaterial, also may have a material adverse impact on the Company’s business, financial condition or results of operations.

Item 6. Exhibits.

Exhibit 31.1 – Certification of Chief Executive Officer of RCI Hospitality Holdings, Inc. required by Rule 13a – 14(1) or Rule 15d – 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 31.2 – Certification of Chief Financial Officer of RCI Hospitality Holdings, Inc. required by Rule 13a – 14(1) or Rule 15d – 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.1 -- Certification of Chief Executive Officer and Chief Financial Officer of RCI Hospitality Holdings, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and Section 1350 of 18 U.S.C. 63.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

RCI HOSPITALITY HOLDINGS, INC.

Date: August 11, 2014 By:/s/ Eric S. Langan
Eric S. Langan
Chief Executive Officer and President

Date: August 11, 2014 By:/s/ Phillip K. Marshall
Phillip K. Marshall
Chief Financial Officer and Principal Accounting Officer