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Accel Entertainment, Inc. (ACEL)

Q2 2021 Earnings Call

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OTHER PARTICIPANTS

Omer N. Sander

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Greg Gibas

Analyst, Northland Securities, Inc.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Accel Entertainment Q2 2021 Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Mr. Mathew Ellis, Senior Vice President of Corporate Strategy.

Mathew Ellis

Senior Vice President-Corporate Strategy, Accel Entertainment, Inc.

Welcome to Accel Entertainment's second quarter 2021 earnings call. Participating on the call today are Andy Rubenstein, Accel's Chief Executive Officer; and Brian Carroll, Accel's Chief Financial Officer. Please refer to our website for the press release and supplemental information that will be discussed on this call. Today's call is being recorded and will be available on our website under Events & Presentations within the Investor Relations section of our website.

Some of the comments in today's call may constitute forward-looking statements within the meaning of the Private Securities Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties, including those related to COVID-19 and its variant strains. Actual results may differ materially from those discussed today and the company undertakes no obligation to update these statements unless required by law. For a more detailed discussion of these and other risk factors, investors should review the forward-looking statements section of the earnings press release available on our website as well as other risk factor disclosures in our filings with the SEC.

During the call, we may discuss certain non-GAAP financial measures. For reconciliations of the non-GAAP measures as well as other information regarding these measures, please refer to our earnings release and other materials in the Investor Relations section of our website.

I will now turn the call over to Mr. Andy Rubenstein.

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

Thanks, Mat. Good morning, everyone. Thank you for joining us for Accel's second quarter earnings call. I'm pleased to report the second quarter of 2021 was the best quarter in Accel's history. We set new revenue and adjusted EBITDA records. As discussed during our June Investor Day, the primary drivers of the higher revenue were the completion of higher bet limit software upgrades and the sixth VGT installations. The combination of these initiatives contributed to the increased location revenue on average between 30% and 35% versus 2019 levels.

We also benefited from the third round of stimulus checks and higher demand due to the lack of other entertainment options as the economy was not fully open. But the improvements in our product offering were the critical drivers for this strong performance. As we enter the summer months and Illinois fully reopened, we'll watch revenue closely to see where it would settle. February, March, and April are traditionally the three best months of the year while June and July are lower performing months.

I'm pleased to share that our July gaming revenue was seasonally better than normal and above our previous expectations. This reinforces our belief that the elevated revenue we are seeing was driven by the initiatives and may be sustainable. Due to Q2's strong results and the strong start to Q3, we are raising our guidance. I'll leave it to Brian to walk you through the new numbers later in the call.

Turning to growth, our sales teams continue to sign additional competitor in organic locations. Including the most recent IGB meeting on July 14, year-to-date, Accel was awarded 168 or 38% of all new licenses. Our ability to win more licenses than our current market share is a strong testament to our sales capabilities and is just one of many competitive advantages that differentiates us from other operators.

There have been some questions about the relatively low number of licenses issued at the last gaming board meeting in July. However, when looking at the calendar, there was a short amount of time between meetings in addition to the July 4 holiday weekend. We will always push ourselves to win more than our share and help our local business partners generate incremental profits which will lead to further location growth. It's too soon to determine what the new total number of annual license will be going forward but we will see a significant amount of runway in Illinois as illustrated in our June Investor Day presentation.

Looking at other states, we remain cautiously optimistic that several states will consider distributed gaming in the future. For example, Virginia recently banned unregulated devices, which could be a first step towards regulated gaming. We will continue to work with the various stakeholders in these states to educate them about the benefits of distributed gaming and the incremental revenues it generates for state and local governments as well as small businesses. Should a new state legalize gaming, we believe our growth playbook in Illinois will enable us to be successful in any future market.

On the M&A front, our pipeline remains active and we expect to announce more opportunities in the future in both existing and incremental states. In Georgia, we completed another acquisition in May when we acquired Island Games, a Southern Georgia operator with 30 locations. Today, we have approximately 60 live locations in

Georgia and a backlog of over 100 locations. We expect both numbers to continue growing and we remain excited about the long-term prospects for us in that market.

Switching to Century, which operates in Montana, Nevada, South Dakota, West Virginia, and Louisiana, we have now submitted all our applications to the various regulators. Due to the large backlog of applications in various states, we will likely not be approved until the first half of 2022 which will impact the timing of the closing versus our initial expectations. We are happy to report that Century continues to perform better than original estimates, and both sides are excited to combine the best practices of both companies.

Overall, Accel is in a strong position to capitalize on the future. We believe we will offer one of the best returns in gaming combined with highly visible growth. To put our growth into context, Illinois distributed gaming industry's revenue grew 60% from Q2 2019 to Q2 2021 as compared to Illinois casinos revenue which decreased 7% over the same period. Over that same period, Accel's growth was 92% overall or 67% when normalized with the Grand River acquisition.

With that, I'd like to turn it over to Brian to walk you through the numbers in more detail.

Brian Carroll

Chief Financial Officer, Accel Entertainment, Inc.

Thanks, Andy, and good morning, everyone. Please remember that we were shut down the second quarter of 2020 so I will omit prior period comparisons where appropriate or make comparisons to the second quarter of 2019.

For the second quarter, we had total revenue of \$202 million and adjusted EBITDA of \$43 million. Revenue per location per day for the second quarter was \$855, an all-time high for Accel and an increase of 35% compared to the second quarter of 2019. As Andy discussed earlier, the primary drivers of the increase were the higher bet limit software and our sixth VGT initiative in addition to some overall higher demand partially driven by the third round of stimulus checks.

CapEx for the second quarter was \$9 million cash spent. A portion of this was related to some deferred payments in the first quarter due to the partial shutdown. As of June 30, we had 13,177 VGTs in 2,527 locations, year-over-year increases of 19% and 8%, respectively. Location attrition continues to remain low and near the pre-COVID historical averages. It is our belief that businesses with incremental gaming revenues had a lower failure rate as compared to businesses without.

As of June 30, we have largely completed the installation of the higher bet limit software and the sixth VGT across our footprint. We believe the second quarter results highlight the positive impact of both initiatives. To refresh everyone's memory, the rollout of the sixth VGT started in January 2020 and the rollout of the higher bet limit software started in July 2020.

At the end of June, our average residual contract length was approximately 6.8 years, the same length as last year and a small increase as compared to last quarter. Our ability to maintain and even raise the residual contract length is a true testimony to the hard work of all our teams, including service, collection, marketing, and relationship management. We have always believed our people give us a competitive advantage, and we'll continue to invest in them to deliver the best-in-class experience for our customers, locations, and players.

At the end of the second quarter, we had approximately \$167 million of net debt, down \$20 million from Q1 and \$266 million of liquidity consisting of \$179 million of cash in our balance sheet and \$87 million of revolver availability.

As Andy mentioned earlier, we are raising our outlook. However, due to the uncertainty of the Delta variant, we have decided to do so conservatively as follows. We are now forecasting to end the year with 13,555 to 13,680 VGTs in 2,590 to 2,615 locations. Revenue for 2021 is now expected to be \$700 million to \$725 million with adjusted EBITDA of \$133 million to \$138 million. CapEx is still expected to be \$20 million to \$25 million cash spend.

Year-end net debt, excluding any acquisition financing, should be approximately \$123 million to \$128 million, implying a year-end trailing debt to EBITDA multiple of only 0.9, giving us ample firepower to pursue additional inorganic and greenfield opportunities. Remember, our annual guidance for 2021 includes the impact of a lower than normal Q1 given the COVID shutdowns in place to start the year.

Back to you, Andy.

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

Thanks, Brian. We are extremely pleased with our performance this quarter and even more excited for what the future holds. It is important to remember that our product today is substantially better than it was in 2019 and that is reflected in our recent results and outlook. We have newer cabinets, better software, higher jackpots, and our locations continue to invest in nicer gaming areas given the strength and importance of the incremental revenues we help them generate.

We are watching the Delta variant closely and hopeful it has a minimal impact, including on our players, customers, and Accel employees. We remain confident that our asset-light, hyper-local business model creates a platform to outperform in difficult times and really thrive under normal circumstances as demonstrated by our recent results. We aim to leverage our differentiated operating model and extremely strong financial position in order to continue our expansion both in Illinois and across the country. Our success would not be possible without our dedicated employees and loyal customers. They are the true competitive advantage of our business that make Accel the preferred choice in distributed gaming.

We will now take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question is from Omer Sander from JPMorgan. Your line is open.

Omer N. Sander

Analyst, JPMorgan Securities LLC

Hi, Andy, Brian, Mat. Congrats on the strong results. Thanks for taking the question.

If I heard correctly, you're mostly done with the rollout of the sixth VGT. As you look through your portfolio, does the focus now shift towards replacing some of the underperforming units both at the existing and the acquired locations? I guess the question is how do you think about that opportunity?

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

Thank you, Omer. We look at the opportunity to replace equipment on a constant basis. It's something that we do literally weekly, evaluating underperforming equipment in specific locations where maybe in that particular micro market, that certain piece of equipment isn't desired and we therefore look at where – what is in demand in that market from the players and then we often shift equipment in there.

So, it's a constant process that we do. We keep up a significant inventory of equipment in our warehouse so we're not having to wait to replace any equipment or update it. So, it's an ongoing process and it's something that we do as a company to optimize the performance for our establishment partners.

Omer N. Sander

Analyst, JPMorgan Securities LLC

Great. Thank you. Are there regions or a portion of portfolio that maybe is underperforming or underindexing relative to the broader part of the portfolio?

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

Yeah. I mean the state of Illinois has [ph] many (14:13) different demographics and there is obviously stronger income levels and stronger demand in certain markets as opposed to others. That may be because there is lack of alternative entertainment options in one area versus another. As an example, the Peoria area because there's a casino that's very close to a lot of the establishments performs at a lower level than some of the northern suburbs of Chicago where there's not – some of these [ph] little (14:53) casino and there's stronger income levels.

Omer N. Sander

Analyst, JPMorgan Securities LLC

Awesome. That's helpful. Thank you and then maybe just a follow-up question. You kind of touched on in your prepared remarks in terms of the new license issuances which also unsurprisingly dipped last year due to COVID. Do you get the sense that there is maybe a desire to catch up on Illinois Gaming commission front and the need to generate tax revenues?

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

To be honest, I don't know exactly their motives but they have done their best to try to go through and authorize as many applications as possible even in today's environment that are somewhat restricted due to their workloads, and they've got a tremendous amount of workload with the new casinos that they're still trying to authorize or review the applications.

So, our gaming board has done the best they can with the staffing that they currently have. They're not staffed to take on a bunch of new casinos plus a rapidly growing industry at once. They're on a normal staffing level and the additional casino expansion is definitely putting strains on some of their resources.

Omer N. Sander

Analyst, JPMorgan Securities LLC

Awesome. Thanks so much. Appreciate the color.

Operator: Your next question is from Greg Gibas from Northland Securities. Your line is open.

Greg Gibas

Analyst, Northland Securities, Inc.

Hey. Good morning, Andy, Brian. Thanks for taking the questions and congrats on the quarter. A couple follow-ups. I guess, first, as we see new state markets legalize video gaming, what kind of gives you confidence that Accel can be an early player operator in those markets?

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

Greg, as we look at these markets, a lot of them were pretty active in working with the legislators or working with the local business partners in those markets. We historically have been a great business partner to the local operators in markets wherever we've gone. And we think that historical success and that reputation of being a good business partner whether it's to the establishment or to the local operators will continue to be our kind of secret to success. And as we've gone into some of these markets already, we've been able to establish great partnerships and I think it will play out with a position of market leadership as the market opens up and we've demonstrated over the last 10 years that Accel can continue to thrive in dynamic markets.

Greg Gibas

Analyst, Northland Securities, Inc.

Great. Appreciate that. And to follow-up, you talked about seeing a good number of M&A opportunities that you mentioned. Wanted to ask, I guess, are those mostly Illinois-focused or are they new market-focused? And then maybe how have those opportunities changed since the last couple quarters? Are you seeing more or is it maybe a little harder to find opportunities now that we're a little bit more out of the pandemic? How are those trends?

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

First part of the question is we [ph] completely (18:57) look at Illinois, there's opportunities but we – our focus has really broadened into new and [ph] like the same (19:07) markets.

And I think for the second part of your question, those opportunities are as good or better than they were a few quarters ago. The certainty during the heat of the pandemic create a pause for many of operators or potential business partners. And as there's greater visibility to their earnings and greater visibility to their potential, both parties are more easily able to come to an agreement on what a partnership would look like.

So, I think you'll see us continue to pursue opportunities in Illinois and outside in these other states and I think it will probably be an accelerating rate in the next few years.

Greg Gibas

Analyst, Northland Securities, Inc.

Q

Awesome. Great. Well, that's all I had. Just wanted to congratulate you on the license wins, too. I mean 38% in a state, that's impressive. But I'll pass it on. Thanks.

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

A

Thank you.

Operator: [Operating Instructions] Your next question is from Steve Pizzella from Deutsche Bank. Your line is open.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

Q

Hey, guys. Thanks for taking the questions. Margins were pretty impressive through the quarter. Can you talk about what you were doing on the cost side and the level of sustainability for these levels moving forward?

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

A

Yeah. Thanks, Steve. A lot of the margin increase was due to the obviously increased revenues. So, the incremental revenues come in at much higher margin.

On the cost side, we haven't been in a cost-cutting mode. We're more in a growth mode and we are continuing to invest in systems, people, to ensure that we can grow both same-store sales as well as future opportunities. And I think the margins will probably kind of move more toward the 19%, low-20s, as we get in a more sustainable revenue performance. So, I think you'll see that the investment with – for the growth will bring those margins kind of down 1 point or so and – but it will also ensure that we will have the growth that we've demonstrated in the past and we expect to do in the future.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Great. Thank you. That's helpful. And then now that you've been in Georgia for about a year now, can you talk about what you've learned in the market and how big you view the opportunity to be there?

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

A

So, Georgia's been an interesting year. We feel very strongly that it can be a very successful market on a long-term basis and we've invested in kind of building our infrastructure, working with the state in a pilot where you can

use a – you can cash out with a redemption card. And where we've seen that redemption card in the pilot, it's made significant improvement in performance or a play at those establishments.

So, we're very excited and hopeful of the expansion of the redemption card and I think on a long-term basis, the market can be meaningful in the overall Accel portfolio.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

Okay. Appreciate it. Thanks, guys.

Q

Operator: [Operator Instructions] Your next question is from Jordan Bender from Macquarie. Your line is open.

Jordan Bender

Analyst, Macquarie Capital (USA), Inc.

Morning, afternoon, guys. Thanks for taking the question. With respect to your guidance, I guess you have July in the books here. I was wondering if you could kind of give the puts and takes on what it might take to hit the bottom or the top half of your guidance range for revenue for the year.

Q

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

Yeah. Thank you, Jordan. I'll let Brian take this one.

A

Brian Carroll

Chief Financial Officer, Accel Entertainment, Inc.

Thanks, Andy. Well, basically with our current run rates on revenue we think will be on the higher side. So it's timing relative to the lower side. It all depends on how we're investing, as Andy mentioned, whether it's internally for building out the Illinois infrastructure and/or for the national platform. So, based on current run rates, though, I think we mentioned in the – a few minutes ago that we thought we were taking a higher – or I'm sorry, a little conservative approach with those guidance and that there is upside. But it's [indiscernible] (25:00) take month by month and see how it goes with everything.

A

Jordan Bender

Analyst, Macquarie Capital (USA), Inc.

Okay. And then as my follow-up here, you've mentioned in your prepared remarks the backlog is pretty strong right now. I was wondering if you could just give us color on kind of where it sits now versus maybe at the end of 1Q or even back to levels like in 2019 or so.

Q

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

Yeah. I would say that we're actually gaining momentum with our backlog and part of that is due to the fact that we're seeing businesses start to reopen or new ownership in businesses that have closed as we've kind of – people have kind of moved past the kind of concerns around long-term effects of the pandemic.

A

So, I think we have a good 12 months of building the backlog ahead of us, I think where you'll see strength in the increase of the locations that we have under contract. And in the past – and I think we'll reach levels probably closer to 2019.

Jordan Bender

Analyst, Macquarie Capital (USA), Inc.

[ph] Well, yeah (26:36). Thanks, guys. Nice quarter.

Q

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

Thank you.

A

Operator: All right and I'm showing no further questions at this time. I would like to turn the call back over to you, Mr. Mat – Mr. Andrew Rubenstein for any additional or closing remarks.

Andrew H. Rubenstein

President, Chief Executive Officer & Director, Accel Entertainment, Inc.

Yeah. Thank you, everyone, for joining us today and as we look forward, we're optimistic as to the continued growth of Accel. Obviously, from a personal and as well as for everyone, we're concerned about the Delta variant and how it's going to affect the economy. And we have gone to – we continue to take precautions to make sure our employees are in the best of health and we hope that everyone does their best to make sure that the economy continues to move forward. So, thank you again.

Operator: Ladies and gentlemen, this does conclude today's conference call. Thank you for your participation and have a great day.

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