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Accel Entertainment, Inc. (ACEL)

Q2 2022 Earnings Call

CORPORATE PARTICIPANTS

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Mathew Ellis

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Andrew H. Rubenstein

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

OTHER PARTICIPANTS

Chad Beynon

Analyst, Macquarie Capital (USA), Inc.

Omer N. Sander

Analyst, JPMorgan Securities LLC

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

Greg Gibas

Analyst, Northland Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Hello everyone, and welcome to the Accel Entertainment's Second Quarter 2022 Earnings Call. My name is Sev, and I will be the operator for your call today. There will be an opportunity for Q&A on today's call [Operator Instructions]

I will now hand the floor over to Derek Harmer, General Counsel and Chief Compliance Officer.

Derek Harmer

General Counsel and Chief Compliance Officer, Accel Entertainment, Inc.

Welcome to Accel Entertainment's second quarter 2022 earnings call. Participating on the call today are Andy Rubenstein, Accel's Chief Executive Officer; and Mat Ellis, 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 and 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 Andy.

Andrew H. Rubenstein

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

Thanks, Derek and good morning, everyone. Thank you for joining Accel's second quarter earnings call. I'm pleased to report we had another strong quarter. We reported revenue of \$228 million and adjusted EBITDA of \$43 million.

In Illinois, same-store sales were essentially flat to the prior year despite the current inflationary environment, and the fact that stimulus checks went out near the beginning of Q2 last year. Our performance continues to demonstrate the strength and resilience of our business model. We believe local businesses will continue to invest in their gaming due to the incremental profits they receive, and players will continue to choose our local, high-quality offering due to its convenience and appeal.

On the expense side, just like most other businesses, we experienced higher than expected costs from macroeconomic related impacts such as increased expenses for labor and fuel. We're continually monitoring our spend and looking for ways to mitigate increased costs without sacrificing our best-in-class service.

Our asset-light business model and highly variable cost structure will allow us to quickly adjust if there are any further changes in the market. On the M&A front, I'm pleased to report that we successfully closed our acquisition of Century on June 1st. The integration is going well, and the companies are working hard as we share our best practices.

I'm also pleased to welcome the entire Century team led by Steve Arntzen, Heidi Schmalz, and Merle Frank to the Accel family. Century is experiencing similar inflationary pressures as we are seeing across the country, but continues to outperform our original estimates.

Looking at new states, I'm excited to share that we entered Nebraska in June with a handful of organic locations. Nebraska's play today is significantly lower than our more established markets, but we see potential for both organic and inorganic growth. We aim to develop Nebraska using the growth playbook we developed in Illinois. This'll be a new market for us, but one that will eventually lead to an attractive earnings stream. And to that point, we recently acquired VVS, an amusement operator, for \$9.5 million.

Overall, our M&A pipeline remains active, and we are evaluating multiple opportunities in Illinois and across the country. Our long-term goal is to continue to increase the percentage of our revenue generated outside of Illinois.

Switching over to Georgia. In May, the Georgia lottery announced it would be extending its Gift Card Pilot program and making it available to all locations. This program allows players to load their winnings onto a prepaid gift card, which substantially reduces one of the biggest barriers players face in the Georgia market. As you would expect, our locations in the pilot program expect increases in play. We're currently working with the lottery in our locations to roll out the pilot program across our network. We see this as an opportunity to expand our presence in the market and the profitability of each location.

In Illinois, our sales team continues to sign additional competitor and organic locations. As of the end of the second quarter, our backlog had grown more than 14% year-to-date. We're working closely with our locations to ensure that they are licensed and live as soon as possible. Whether we look at the number of eligible businesses without gaming or the number of VGTs per capita, we believe Illinois still has highly visible growth.

Overall, Accel achieved several milestones this quarter with the Century acquisition and expansion in Nebraska. More importantly, we continue to build a platform to further expand into existing and new markets. Our local business model, low capital requirements, and highly visible growth offers one of the best returns in gaming.

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

Mathew Ellis

Chief Financial Officer, Accel Entertainment, Inc.

Thanks, Andy, and good morning, everyone. For the second quarter, we had total revenue of \$228 million, a year-over-year increase of 13%, and adjusted EBITDA of \$43 million, which was flat compared to last year. This quarter's results include one month with Century. And it is important to remember that Century operates in markets where the revenue split between Century and the location is negotiated. The margins are attractive, but lower than our existing business.

Illinois same-store sales were essentially flat relative to the prior year. Considering the inflationary environment and stimulus checks issued last year, we believe our performance reinforces demand for our offering remains strong. CapEx for the second quarter was \$6 million cash spent. As of June 30, we had 22,128 terminals and 3,489 locations. Year-over-year increases of 68% and 38%, respectively. Location attrition continues to remain low and near the pre-COVID historical averages.

At the end of the fourth quarter, we had approximately \$282 million of net debt and \$601 million of liquidity, consisting of \$220 million of cash on our balance sheet and \$381 million of availability on our current credit facility.

I'd now like to provide an update on our efforts to return capital to shareholders, specifically our share repurchase program. As you're all aware, we announced a \$200 million share repurchase program in November of 2021. As we find the opportunity to return capital to shareholders in the form of buybacks, an attractive use of our significant free cash flow.

During the quarter, we purchased \$25 million of Accel stock at an average purchase price of \$10.96 per share. Since the program started, we have repurchased more than \$55 million of Accel stock through the end of July. Given our relatively under levered balance sheet and strong free cash flow, we are in a position to make exciting investments while continuing to appropriately return capital to shareholders.

Turning to outlook, with the Century acquisition closed, I would now like to provide updated guidance. I'll provide guidance with the in-year impact of Century as well as the pro forma impact. As Andy and I mentioned earlier, demand continues to remain strong, but we are seeing increased expenses and slightly lower revenue growth compared to when we first issued guidance in late 2021.

We expect that in 2022 with 22,700 to 23,200 terminals and 3,550 to 3,600 locations, 2022 revenue is estimated to be \$960 million to \$990 million. Assuming the full year benefit from Century revenue is estimated to be \$1.07 billion to \$1.13 billion. Adjusted EBITDA was estimated to be \$160 million to \$165 million. Assuming a full year benefit of Century, adjusted EBITDA is estimated to be \$170 million to \$175 million. CapEx is estimated to be \$25 million to \$30 million of cash spend. Assuming a full year of Century CapEx is estimated to be \$30 million to \$35 million of cash spend.

Back to you, Andy.

Andrew H. Rubenstein

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

Thanks, Mat. We are pleased with our performance this quarter and are focused on executing our growth strategy and the strong foundation we have built. We remain confident that our locally focused business model creates a platform to outperform in difficult times and thrive under normal circumstances. We aim to leverage our proven asset-light business model and extremely strong financial position to continue our expansion and return capital to our shareholders.

Our success would not be possible without our dedicated and high-performing employees. They are the true competitive advantage of our business that make Accel the preferred choice in our markets.

We will now take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Chad Beynon from Macquarie. Chad, please go ahead.

Chad Beynon

Analyst, Macquarie Capital (USA), Inc.

Hi. Good morning. Thanks for taking my question and congrats on the Century closure. Also, thanks for giving guidance. I know a lot of unknowns out there and most companies aren't willing to give it at this point. But since you did, wanted to take a stab on that, given your view on lower revenue growth than what you were originally projecting, is this something that you're seeing in recent trends in June or July, or are you maybe just taking a conservative approach, just given the world that we live in, the news that we're seeing, and kind of the macro and inflationary environment? Thanks.

Andrew H. Rubenstein

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

Thanks, Chad. This is Andy. We're basically looking forward relative to some things we're seeing in kind of the macro environment. We haven't seen anything significant directly in the markets that we operate in. But as we see prices rise in some of the discretionary spending categories as well as the inflation that we're seeing in fuel and other cost that affect our players, we're kind of taking a more cautious approach, but we haven't seen anything in June-July that's dramatic. And we feel pretty confident that our position today and where we sit in the marketplace in the gaming world is a relatively stable revenue flow.

Chad Beynon

Analyst, Macquarie Capital (USA), Inc.

Okay. Great. Thanks for clarifying that. And then in terms of the Nebraska market, can you just talk about how big that market can be if that could be kind of a Top 3 market for you guys or if it's just another opportunity to kind of build on your current units? Thanks.

Andrew H. Rubenstein

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

Yeah. It's really early to determine it, the challenges with the Nebraska, is it has a very unique style game and a very underdeveloped gambling market. And as you may be aware, casinos are going to be coming along in that market. So, we'll get some indication of the potential there, but today the machines are effectively – an amusement skill-type games that are regulated. And they – we don't expect them to perform anywhere close to the Illinois market. And we'll look – we're investing early to see what we can develop. And we'll have better kind of information and data probably at around kind of mid-year 2023.

Chad Beynon

Analyst, Macquarie Capital (USA), Inc.

Thanks, Andy. Appreciate it.

Operator: Our next question.

Andrew H. Rubenstein

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

Thank you.

Operator: Thank you. Our next question comes from Steve Pizzella from Deutsche Bank. Steve, please go ahead.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

Hey. Good morning, guys. Thanks for taking my questions. Now that the Century acquisition has closed, does that allow you to be more aggressive on the M&A front? Are there similar acquisitions inside Accel that are out there you think? And how has seller expectations evolved over the last six months?

Andrew H. Rubenstein

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

Yes. Thanks, Steve. We haven't really changed our approach. We're always evaluating each acquisition opportunity as it's individual opportunity. And we've continued to proceed, proceed in a way that is thoughtful, and we're obviously taking into consideration the current economic environment.

We have seen a slight change in the acquisition environment where people are starting to realize that this significant growth that they were trying to price their businesses going forward isn't a reality that we're going. We had obviously substantial growth 2018, 2019, 2020, 2021 and – but that can't continue at those levels. So there is – there are still opportunities. We're evaluating them. I think where the market goes in terms of pricing has yet to be determined.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

Okay. Thanks. And then, just dwelling on path for the legacy kind of Illinois business, I think you've talked about margins being able to potentially get 19% to 20%. Can you talk about where you think these current portfolio margins can get to [ph] now when (00:16:43) Century legacy margins are relatively low?

Andrew H. Rubenstein

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

Yeah, I may have Mat pipe in on that.

Mathew Ellis

Chief Financial Officer, Accel Entertainment, Inc.

A

Hi, Steve. How are you? Well, what I would say is that the Illinois sort of margin is intact. As we've always said, we're continuing to build this base to support far more than Illinois and Century. And Nebraska is sort of a first step there and we've got growth in Georgia.

It's a little too soon to tell what the overall margin would be thinking of the competitive nature of the sort of Nebraska – excuse me, the Nevada-Montana markets, but I think the pro forma guide gives you sort of a blend of everything. But at this point, for competitive reasons, we're not necessarily breaking out margins by specific market.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Great. Appreciate it. Thanks, guys.

Operator: Our next question comes from Omer Sander from JPMorgan. Please go ahead.

Omer N. Sander

Analyst, JPMorgan Securities LLC

Q

Hey, good morning, Andy, Mat. Thanks for taking my questions. First, a question on Century and the growth in Nevada and Montana and Illinois obviously core Accel had additional licenses being granted plus you had the six months machine. Can you talk about the growth landscape in Nevada, in Montana? How much of the locations and VGT growth in your full year guidance is from these markets? And if our math is correct, it looks like the locations in Nevada and Montana are lower than your Investor Day 14 months ago. What's driving that dynamic?

Mathew Ellis

Chief Financial Officer, Accel Entertainment, Inc.

A

Hey, Omer. So, when you see the Nevada and Montana market, they're pretty stable. There's always an opportunity to grow. It's not like Illinois, where there's a huge organic growth path. Some of the ebb and flow from the Investor Day has just been naturally the cycling of locations. But overall Century continues to grow, continues to perform really well. You can kind of see it combining, but in other cases you might see and as you'll remember that they have more terminals per location. So, sometimes you're optimizing the mix. But overall, like we've said on the call Century still outperforming our original estimates, which is great to see. And, I would say we're going to continue sort of combining our best practices and our growth playbook and their operating efficiencies to kind of build just a bigger and better company.

Omer N. Sander

Analyst, JPMorgan Securities LLC

Q

Okay. Right. Thanks. And then maybe shifting to Illinois, last quarter, you talked about the removal of some of the idle machines due to the removal of 72. Did that weigh on any of the unit growth in the 2Q? And maybe, another way of putting that can you bifurcate the gross units added in Illinois versus the removals in the 2Q?

Mathew Ellis

Chief Financial Officer, Accel Entertainment, Inc.

A

Sure. Not as pronounced as Q1, which is why we didn't really address it. Certainly, a handful of locations still in that cycle, but obviously, we're starting to go in. But, to quantify it, another 10 to 20 locations, probably. But as we sort of address, it sort of stabilized now, and you can see obviously sequentially, we are starting to grow again.

Omer N. Sander

Analyst, JPMorgan Securities LLC

Okay. Thanks so much.

Q

Operator: Our next question is from Greg Gibas from Northland Securities. Please go ahead.

Greg Gibas

Analyst, Northland Securities, Inc.

Hey. Good morning, Andy and Mat. Thanks for taking the questions. If I could follow-up on the Nebraska markets, it sounds like it's obviously very early there. But in terms of the market structure, maybe, how do regulations differ? And then, are establishments pretty similar to the establishments where terminals are in Illinois? And I guess maybe how we should think about kind of the pace of your expansion in the state.

Q

Andrew H. Rubenstein

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

Thanks, Greg. This is Andy. It's, like I said, the type of equipment is so unique that they are not the traditional manufacturers that you see in the casinos nor even in the steel markets. And that's going to prohibit growth significantly. There's challenges in terms of getting inventory, and the type of play is definitely more similar to amusement play. We – the typical location only has a few machines and it's really going to take a while for the players to really embrace this as a gaming option. That being said, the market is not new. It's probably been operating for three to four years with kind of a non-regulated version prior to that.

A

So, we're like I said investing in the market, looking to see how the players develop, seeing if the – there is real interest in a gaming entertainment and the types of facilities are somewhat similar to what you see in Illinois. Obviously, the population is significantly lower in Nebraska, and therefore the games will be concentrated more on some of the tavern and truck stop types of environments.

As far as regulations, they are regulated more like amusement skill market than they are a gaming market. The Nebraska regulators are very attuned to what's going on in the market, and have been very helpful and really been collaborative as we've moved into that market. But it is a – it's different obviously than a traditional route to a casino market.

Greg Gibas

Analyst, Northland Securities, Inc.

Great. Appreciate all the color there, Andy. I wanted to ask too, just kind of curious on what do you think you're how – I guess, how your new establishment win rate has trended in the quarter and whether you believe you're continuing to gain market share in Illinois.

Q

Andrew H. Rubenstein

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

Can you just repeat that again?

A

Greg Gibas

Analyst, Northland Securities, Inc.

Q

Yeah. Sorry about that. Just kind of curious how you think your win rate has trended on new establishments and I guess within the quarter, and then whether you still think you're gaining market share in the state.

Andrew H. Rubenstein

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

A

So, it is – yeah, so I'm trying to understand. So new establishments mean ones that are just coming online with us in Illinois. Is that what you're asking?

Greg Gibas

Analyst, Northland Securities, Inc.

Q

I guess in terms of all new establishments that kind of turn on in the state, how many of the overall percentage is kind of Accel winning estimate, and maybe how that's trended?

Andrew H. Rubenstein

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

A

Okay.

[indiscernible] (00:24:52)

Andrew H. Rubenstein

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

A

...let Mat answer that question.

Mathew Ellis

Chief Financial Officer, Accel Entertainment, Inc.

A

Yeah. So what I would say is we're continuing to sign more. Andy referenced on the call our backlogs are growing, which is always a good sign. We quantify that. We're not talking about just pure signed agreements, but qualified, meaning, obviously competitor locations, but also organics that are in municipalities with gaming, capital liquor licenses, all of that.

So, generally speaking, we're still doing very well on that front. We always sort of kept the backlog closer to our vest. But the – what we're focused on, obviously, the flipside of the backlog is getting the locations license a lot. But all we can focus on is continuing to grow those backlogs, which we are, and then providing, helping our locations through the licensing process. So, like we've always said, Illinois still has room to grow. We look at it both as liquor licenses without gaming and VGTs per capita. It's certainly the market continues to get bigger, but we still see a good amount of growth in the future.

Greg Gibas

Analyst, Northland Securities, Inc.

Q

Got it. Very helpful. And I guess just last one from me, strategic rationale for the VVS purchase and maybe what multiple does that purchase equate to.

Andrew H. Rubenstein

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

A

So, the strategic – our concept there was that they have an established route in the market. They're well positioned and a really good team that – of people that they have at VVS. And the actual multiple is kind of to be determined because as we look at this market, there is a significant earn-out that as they will help us to grow the market, we'll kind of be able to – they'll be able to grow their payment with [indiscernible] (00:27:01) to expand.

So, like I said earlier, the – a lot of the locations just have a few machines. And as it expands, we're able to add more machines. The payment will increase, and then we'll have a better kind of concept or a more firm number as to what the multiple was.

Greg Gibas

Analyst, Northland Securities, Inc.

Q

Okay. Makes sense. Thanks, guys.

Operator: So, we have no further questions in the queue. I will hand the floor back to Andy Rubenstein.

Andrew H. Rubenstein

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

Right. I want to thank everyone for joining us this morning. We had a pretty good second quarter, we're really pleased with it and as we're looking forward to the second half of this 2022 year, we think that you'll continue to see us growing, expanding in some of the markets that we're in, and identifying opportunities for us to continue to grow. And we appreciate you joining us this morning, and look forward to talking to you at summer's end. Thank you.

Operator: This concludes today's conference call. Thank you very much for joining. You may now disconnect your lines.

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