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Accel Entertainment, Inc.

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Earnings Call

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Call Participants

EXECUTIVES

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Co-Founder, President, CEO & Director

Derek Harmer

General Counsel, Chief Compliance Officer & Secretary

Mark T. Phelan

President of U.S. Gaming

Mathew Ellis

Chief Financial Officer

ANALYSTS

Gregory Thomas Gibas

Northland Capital Markets, Research Division

Samir Morris Ghafir

Macquarie Research

Steven Donald Pizzella

Deutsche Bank AG, Research Division

Presentation

Operator

Good afternoon, and thank you for joining the Accel Entertainment Q3 2024 Earnings Call. My name is Kate, and I will be the moderator for today's call. [Operator Instructions]

I would now like to turn the call over to Derek Harmer, General Counsel and Chief Compliance Officer. Derek, you may proceed.

Derek Harmer

General Counsel, Chief Compliance Officer & Secretary

Welcome to Accel Entertainment's Third Quarter 2024 Earnings Call. Participating on the call today are Andy Rubenstein, Accel's Chief Executive Officer; Mat Ellis, Accel's Chief Financial Officer; and Mark Phelan, Accel's President of U.S. Gaming. 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. 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.

Any projected financial information presented in this call is for illustrative purposes only and should not be relied upon as being predictive of future results. The inclusion of any financial forecast information in this call should not be regarded as a representation by any person that the results reflected in such forecasts will be achieved. 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 Harry Rubenstein

Co-Founder, President, CEO & Director

Thanks, Derek, and good afternoon, everyone. Thank you for joining us for Accel's third quarter earnings call. We had another strong quarter. We reported revenue of \$302 million and adjusted EBITDA of \$46 million, proof of the resiliency of our convenient local gaming offering. Secondly, we made solid progress in our pending acquisition of Fairmont Park, which is expected to close this quarter.

In terms of financial performance, our largest market, Illinois, posted market-wide GGR growth of 5% year-over-year, outperforming Illinois casinos, which were down 1% year-over-year on a comparable basis. We are proud of the strong foundation we have built in our home state, leading in a model that's a win-win-win for our state, our customers and local convenience-based gaming providers like us. We continue to optimize our largest state-based route footprint, managing head count and broader operational excellence to more than offset the modest drag from recent tax increases.

During the quarter, our location count was down a bit sequentially. In Illinois, this was due to 2 factors: First, the strategic closures of 22 underperforming locations. And second, some openings were delayed by the cancellation of the July Illinois Gaming Board meeting. The subsequent IGB meeting was in September and not all locations were live by month end. By the middle of October, the remaining licensed locations were live.

Regarding our strategic closures in Illinois, we continue to review our portfolio and look for opportunities to prune. We have identified a subset of our locations within our bottom decile performers that we will phase out over coming quarters. Given we also have an attractive pipeline of planned openings at promising locations, we expect near-term Illinois net unit growth to be flattish with some potential positive impact on EBITDA and returns on invested capital as we rotate locations.

Across our footprint, we continue to refine our sales and operating model, focusing on the highest hold-per-day locations. This improvement in the composition of our portfolio will help both top line and bottom line, driven by choiceful segmentation and resource allocation. In Nebraska, we're encouraged that strong revenue growth during the quarter was driven by hold per day. We are seeing fruits of our strategic product shift, swapping in higher-performing games and removing lower performing revenue share units. We see more runway to do this across our fastest-growing market.

On the regulatory front, Illinois continues to lay the groundwork for ticket in, ticket out, also known as TITO, which should make cash processing more efficient and more importantly, create a more convenient experience for our players, allowing them to switch between games and our venues without cashing out and cashing in each time, making our sites more akin to a casino experience. We expect TITO to be rolled out in the first half of 2025. We continue to monitor the regulation related to this.

Before I turn it over to Mark, I want to take a few minutes to talk about Accel's value proposition and where we see our greatest opportunities for growth. For both our customers and players, we provide a high-quality slot gaming experience at a low price point that can be accessed by our players at a local convenient retail location of their choosing in 15 minutes or less. We support retail gaming partners by providing them with high-margin revenue per square foot gaming products and self-service technology. We instill player loyalty through our rewards programs and create memorable player experiences with our diverse game selection.

And finally, we maintain collaborative and reliable partnerships with regulators across 11 different regulatory structures, all while generating attractive returns on capital in the low teens. In our core route-based business model, our steady-state growth algorithm is both simple and compelling. We target low single-digit revenue growth, mid-single-digit EBITDA growth, high single-digit free cash flow growth and core business CapEx quickly compressing down towards \$40 million.

Looking ahead, the primary levers for growth in our core route business are: one, growing organically in Illinois, Nebraska and Georgia through both newly licensed establishments and converting competitor locations; two, driving profitability in Nebraska and Georgia through operational execution and strategically positioning ourselves in the face of favorable legislation; three, collecting a greater share of location economics through selectively owning establishments in markets where this is permitted and is otherwise profitable; and four, preparing ourselves for future opportunities in new states likely to legalize local gaming in the future.

Outside of our core business, our M&A pipeline remains active as demonstrated by the Fairmont announcement. We also expect to provide an update on Louisiana before year-end. We are confident that we can leverage our proven capabilities as a local gaming operator to convert opportunities in the attractive and sizable nationwide \$15 billion GGR local gaming market. Most assets in this market are unconsolidated and sit at EBITDA levels that are below the radar of the larger gaming companies, conditions that play to our strength. As a prime example of these opportunities, I'm going to turn it over to Mark.

Mark T. Phelan
President of U.S. Gaming

Thanks, Andy. We announced the acquisition of Fairmont last quarter for approximately \$35 million in Accel stock. The acquisition includes a master sports betting license with a long-term partnership with FanDuel, a race track, and off-track betting facility as well as multiple opportunities across the state and the ability to develop a best-in-class locally focused casino. We also welcome Bill Stirtz and Rob Vitale, both world-class value creators as long-term investors in Accel. Much of this transaction builds on the core

capabilities in local gaming that we have honed over the last 15 years with attractive returns on capital and free cash flow.

In September, we received transaction approval by the Illinois Racing Board. On October 24, we received required approvals from the Illinois Gaming Board. With these approvals, we can move forward with closing Fairmont, which we expect to close in early December. We will provide an update then.

Looking ahead, November 2 is the final day of racing for the 2024 season. Subsequently, we will begin construction of the Phase 1 facility with permits pulled and approved. We've also hired a General Manager to oversee casino development and operations and onboarded an industry veteran to consult on all aspects of horse racing. As a reminder, we expect to develop this project in 2 phases. Phase 1 will be built in the existing grandstand with approximately 250 slot machines, 4 to 6 electronic table games, improved food and beverage amenities and a FanDuel-branded Sportsbook. This will be done with relatively low capital intensity and is expected to open in second quarter of 2025.

For Phase 2, we'll erect a permanent casino on site with detailed plans for 600-plus slot machines, 24 table games, improved food and beverage amenities and a new larger FanDuel Sportsbook. We are combining our local gaming expertise with key partnerships in the areas outside our core business to create an exceptional customer offering, and we are encouraged by the progress so far. Overall, Phase 1 and Phase 2 casino build-out plans remain on track, and we will provide additional updates when the time comes.

With that, I'll pass it over to Mat to go over the fundamentals of the quarter.

Mathew Ellis

Chief Financial Officer

Thanks, Mark, and good afternoon, everyone. For the third quarter, we had total revenue of \$302 million, a year-over-year increase of 5.1% and adjusted EBITDA of \$46 million, a year-over-year increase of 3.9%. As of September 30, we had 25,729 terminals and 4,014 locations, year-over-year increases of 4.1% and 2.8%, respectively.

Revenue per location for the third quarter in our core states was as follows: Illinois was \$839 per day, an increase of 1.7% year-over-year. Montana was \$613 per day, an increase of 3.7% year-over-year. Nevada was \$802 per day, which was flat to the prior year, and Nebraska was \$257 per day, an increase of 16.8% year-over-year. The increases in Illinois, Montana and Nebraska really emphasize the strength and resilience of both our business model and more importantly, consumers who continue to choose our high-quality local and convenient offering.

Capital expenditures for the third quarter were \$17 million cash spend. As a reminder, the primary driver of our elevated CapEx was the introduction of 4 new high-performing gaming terminals at the same time in Illinois. We view this year's and last year's elevated CapEx as onetime in nature. For 2024, we are projecting CapEx across our core to be between \$60 million and \$65 million, a decrease of more than 20% from last year. Over the longer term, we expect CapEx to decrease even further towards \$40 million, as Andy highlighted earlier. This will be an encouraging boost to capital returns and thus returns on capital.

At the end of the third quarter, we had approximately \$289 million in net debt and \$538 million of liquidity, consisting of \$265 million of cash on our balance sheet and \$273 million of availability on our credit facility. On our capital allocation strategy, we continue to make progress on our \$200 million share repurchase program. During the quarter, we repurchased 585,000 shares at an average purchase price of \$10.52 a share for a total of \$6 million. We are 70% of the way through the repurchase program with 13.5 million shares repurchased at a cost of \$140 million. With our strong balance sheet and low leverage, we are in a unique position where we can grow our business and return capital to shareholders.

With that, I'd like to turn it back over to Andy.

Andrew Harry Rubenstein

Co-Founder, President, CEO & Director

Thanks, Mat. As I mentioned earlier, we are very pleased with our strong performance this quarter and excited for what the future holds with Fairmount Park. For the immediate term, we remain focused on executing our growth algorithm with improving cash flow and returns and closing the Fairmount acquisition. Long term, we look forward to capitalizing on the significant growth opportunities ahead of us as an aligned and incentivized Accel team.

Accel remains strong as evidenced by our third quarter results and our healthy balance sheet, enabling us to pursue a multipronged approach to capital return, making us a compelling investment. Local gaming is an attractive growing niche within the broader gaming market with multiple opportunities to generate strong and consistent revenue and EBITDA growth as well as strong free cash flow and returns on capital. We will now take your questions.

Question and Answer

Operator

[Operator Instructions] The first question will come from the line of Steve Pizzella with Deutsche Bank.

Steven Donald Pizzella

Deutsche Bank AG, Research Division

Just following up on the closures. I guess, why is now the right time? How did you identify these locations? And how should we think about location win per day and EBITDA margins improving in Illinois moving forward?

Andrew Harry Rubenstein

Co-Founder, President, CEO & Director

So it's not a question of now is the time. It's something that we're constantly evaluating. Recently, we've -- call it, in the last year, we've seen the continuation of inflation in wages, in a lot of the cost of goods sold or assets that we deploy. But most recently, the biggest hit to was the tax hike. We had -- in the last legislative session, the state took an additional 1% tax on the industry, half of it hitting us and half of it hitting the establishment owners.

And in many of the situations, it pushed us into a lower profit margin than we'd like to be. And we have reacted to that by taking a closer look at those locations and whether we could make adjustments in our cost structure. And when we couldn't get it back to the level that we see fit, we have had to make the difficult decisions to redeploy our equipment either in other locations or to bring -- to exit the actual location.

Steven Donald Pizzella

Deutsche Bank AG, Research Division

Okay. That's helpful. And then just wanted to follow up on Fairmount, if we could. Do you have any updated thoughts on the projections for the acquisition at all? And can you just remind us exactly what you get on the sports betting side and some of the economics of those arrangements? And then also, if Illinois was to ever legalize iCasino, how would you think about this in the context of potentially having leverage to an iCasino product, but also the potential impact on the route gaming business?

Andrew Harry Rubenstein

Co-Founder, President, CEO & Director

Okay. Thanks, Steve. I'm going to have Mark Phelan, who's leading the project for us answer.

Mark T. Phelan

President of U.S. Gaming

Steve, in terms of Fairmount, all of our construction costs are so far in line with what we projected back in July, which is all public. I think we said ultimately, the project would be a \$20 million to \$25 million EBITDA project, and we still feel really comfortable about that over the next couple of years. In terms of the deal with FanDuel, it's confidential. I can just say it's a very favorable relationship for both Fairmount and FanDuel. And the contract extends for a significant period of time well beyond sort of the next couple of years, and we're excited to be partners with them.

Operator

The next question will come from the line of Chad Beynon with Macquarie.

Samir Morris Ghafir

Macquarie Research

This is Sam on for Chad. We wanted to ask about M&A activity. Any new opportunities that you guys are seeing in the sub-\$25 million EBITDA level? Obviously, there's a lot of runway, as you mentioned in your opening remarks. So maybe also getting a better idea of what are some of the biggest hurdles that you currently see in the market that you need to overcome with potential targets in order to come to terms? Any color would be helpful.

Andrew Harry Rubenstein

Co-Founder, President, CEO & Director

Thanks, Sam. This is Andy. We've seen a fair amount of inventory come on to the market. There's some that are actively being marketed as well as a couple of kind of private conversations. The bid-ask is -- differential is narrowing. And I think a lot of it is due to the fact that some of the sellers have recognized the value of a partnership with Accel. And I think that will -- just similar to what market referenced in our prepared statements, there are people like Bill Stiritz that recognize Accel as a great partner and one that can get them high returns on their investment.

And in a lot of these situations, the seller has either decided to partner with Accel and participate going forward or recognizes Accel's ability to create additional value. So I think you'll see in the next 12 to 18 months more of these types of opportunities, very local. A lot of them tend to be small business owners that identify Accel as a very good partner.

Samir Morris Ghafir

Macquarie Research

And then as a follow-up, I wanted to ask about any potential state legislation that you will be tracking closely into next year and whether this upcoming election could potentially have an impact on the state legislation as legislators shuffle around, et cetera.

Mark T. Phelan

President of U.S. Gaming

Chad, this is Mark. I'm sorry, Sam. We track a couple of the higher sort of probability states are Pennsylvania, Virginia, North Carolina, Missouri. In particular, we're focusing on North Carolina as they have a real need to raise revenues for a variety of reasons, and they have a long history of great gaming.

In terms of the election coming up, certainly, states with dominant political positions that might be at risk are good candidates for potential legislation if results tend to take away those dominant political positions. And we have a couple of states like that, and we're watching them very closely.

Operator

The next question will come from the line of Greg Gibas with Northland Capital Markets.

Gregory Thomas Gibas

Northland Capital Markets, Research Division

I wanted to follow up on the location closures, and you maybe spoke on this, but what was the estimated impact to the business' profitability as a result of that?

Mathew Ellis

Chief Financial Officer

Greg, it's Mat. Thanks for the question. When you think about our base and the denominator to see the impact on 22 locations, it's pretty minimal. As Andy sort of mentioned, this is always happening. With some of the recent changes, we might accelerate some of these closures. So as we talked about before, I mean, this is part of our overall growth, again, that sort of mid-single-digit EBITDA growth, low single-digit revenue, higher free cash flow. But to -- when you think about such a small number, it's going to have a minimal impact on those metrics. But I think overall, it will be important to achieve that goal about growth that we talked about.

Gregory Thomas Gibas

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Northland Capital Markets, Research Division

Yes. Got it. That's fair. And a couple of questions relating to, I guess, the core Illinois market. You pointed out Illinois casinos being down 1% year-over-year versus your growth. And other than kind of the -- probably a lot could be attributed to just the different business model. Why do you kind of point -- or what do you kind of point to in terms of the outperformance there? Are there any other factors maybe besides that? And then separately within Illinois, TITO, how do you kind of expect ticket in, ticket out to impact the business?

Andrew Harry Rubenstein

Co-Founder, President, CEO & Director

So -- this is Andy, thanks, Greg. The -- like the product that we put out in the marketplace tends to be a level above a lot of our competitors in terms of we [refresh] what we have in the -- in our establishments with the latest equipment. We have very similar games to what they see in the casino. And the fact that our product is very local, they don't have to make a big evening to go to the casino. And on one given machine, they get the equivalent of 10 to 15 slot machines because of the multigame offering.

So we're seeing more and more of a customer selection to play in their local either tavern, convenience store as opposed to making the trip to the regional casino. And I think kind of this environment is such that it benefits us. We still have strength in the consumer, but they're being a little more prudent. And we look forward to providing a quality offering to them, both in times of where the economy is in flux to when it's -- at its peak and even when there's challenges, people choose the quality offering that we provide.

Looking at things such as TITO, I think that will provide a lift. The question is how much. But we're looking forward to that board sometime in the second quarter next year. And that, I think, will lift -- will provide some growth in the industry because of the convenience and the ability to have kind of a better experience.

Operator

At this time, there are no further questions registered in the queue. [Operator Instructions] We do not have any further questions in the queue. So I will turn the call back over to Andy Rubenstein.

Andrew Harry Rubenstein

Co-Founder, President, CEO & Director

I just want to thank everybody for joining us. We want to wish you guys an early happy holidays starting tomorrow with Halloween, and we look forward to rejoining you in the new year with some positive results for the year and a lot of exciting news for 2025. Thank you.

Operator

That concludes today's call. Thank you all for your participation, and you may now disconnect your lines.

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