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Accel Entertainment, Inc.

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Earnings Call

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Call Participants

EXECUTIVES

Andrew Harry Rubenstein

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

Chad C. Beynon

Macquarie Research

Gregory Thomas Gibas

Northland Capital Markets, Research Division

Steven Donald Pizzella

Deutsche Bank AG, Research Division

Presentation

Operator

Good afternoon. Thank you for attending today's Accel Entertainment Q2 2024 Earnings Call. My name is Tamia, and I will be your moderator for today's call. [Operator Instructions]

I would now like to pass the conference over to your host, Derek Harmer, General Counsel and Chief Compliance Officer.

Derek Harmer

General Counsel, Chief Compliance Officer & Secretary

Welcome to Accel Entertainment's Second 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

Thank you, Derek, and good afternoon, everyone. Thank you for joining us for Accel's second quarter earnings call. This is a very exciting time here at Accel.

First off, we had another record-breaking quarter. We reported revenue of \$309 million and adjusted EBITDA of \$50 million, positive proof of the strength of our convenient local gaming offering. Secondly, we announced our pending acquisition of Fairmount Park, which Mark will discuss in more detail shortly.

In terms of financial performance, our home market in Illinois posted market-wide GGR growth of 5% year-over-year, and Accel outperformed that, growing revenues by 6%. This is in stark contrast to Illinois casinos, which were flat year-over-year. We're proud of the strong foundation we've built in our home state, leading in a model that's a win, win, win for our state, our customers and gaming providers like us. We added almost 50 locations nationwide this quarter, highlighted by 30 in Illinois and 11 in Montana.

This is another way we differentiate ourselves from traditional casinos, unit growth. This unit growth was in addition to positive same-store sales growth in Illinois, Montana and Nebraska, which was primarily driven by increased demand in our offering, new machines and favorable weather. In Nevada, we saw a modest decline in same-store sales due to an overall increase in supply in the greater Las Vegas locals market.

Turning to expenses. Earlier this year, Illinois raised the state gaming tax from 34% to 35% effective July 1. The increase is split evenly between us and our location partners. Based on our highly variable cost structure, we will hopefully offset most of the increased expense.

On the regulatory front, we're seeing signs Illinois will implement ticket in, ticket out 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. We expect TITO to be rolled out in the next 18 months.

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.

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, oftentimes 15 minutes or less. We support our 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 and high single-digit free cash flow growth and core business CapEx quickly compressing down towards our annual depreciation of \$40 million.

Looking ahead, the primary levers for growth in our core route business are: one, growing organically in Illinois, Nebraska and Georgia. We both newly licensed establishments, and converting competitor locations; two, collecting a greater share of location economics through selectively owning establishments in markets where this is permitted and is otherwise profitable; three, driving profitability in Nebraska and Georgia through operational execution and strategically positioning ourselves in the face of favorable legislation; 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 Fairmount announcement. We are confident that we can leverage our proven capabilities as a local gaming operator to convert opportunities in the attractive and sizable \$15 billion GGR local gaming market. Most assets in this market are unconsolidated and sit at EBITDA levels that are below the radar of larger gaming companies, conditions that play to our strengths. 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. As we all know, we announced the acquisition of Fairmount for approximately \$35 million in Accel stuff. The acquisition includes a master sports betting license with a long-term partnership with FanDuel, a racetrack, off-track betting opportunities and the ability to develop a best-in-class locally focused casino.

We also welcome Bill Stiritz 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've honed over the last 15 years with attractive returns on capital and free cash flow. We are currently going through the licensing process with the Illinois Gaming Board and the Illinois Racing Commission and anticipate that the transaction will close in the fourth quarter of this year.

As a reminder, we expect to develop this project in 2 phases, with total development spend of approximately \$85 million to \$95 million, in addition to the 3.5 million Accel shares exchanged for the Fairmount Park assets. Phase 1 will be built in the existing grandstand adding 200 slot machines, 4 to 6 table games and continuing to utilize the existing FanDuel sportsbook and food and beverage outlet. This will be done with relatively low capital intensity and is expected to open in second quarter of 2025.

The Phase 2 will direct the permanent casino on-site with detailed plans for 500 slot machines, 24 table games and a new larger FanDuel sportsbook. We are combining our local gaming expertise with key partnerships in areas outside our core to create an exceptional offering. For the horse track, we will build on Fairmount's long-term horseracing management team as well as consultation from industry experts. For the casino, we're engaged with RRC gaming management, including Tony Rodio, former CEO of Caesars Entertainment and Holly Gagnon, CEO of HGC Gaining Hospitality and former CEO of several casino companies, including Seneca Gaming.

In food and beverage, we're discussing food and beverage amenities with several experienced F&B operators. In sports betting, we're assuming the existing long-term relationship with FanDuel, the #1 sportsbook in Illinois. Broadly, these partners will complement Accel's expertise in local gaming regulatory partnerships and efficient capital allocation. Within 5 years, our conservative underwriting implies a \$20 million to \$25 million adjusted EBITDA opportunity. We're excited that the acquisition is expected to be accretive to adjusted EBITDA and free cash flow at an implied multiple of approximately 5.5x.

This opportunity takes advantage of our core expertise and build on Accel's strong distributed route-based platform and is an exciting milestone in our national expansion in the local gaming market.

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 second quarter, we had record revenue of \$309 million, a year-over-year increase of 5.7% and adjusted EBITDA of \$50 million, a year-over-year increase of 6.5%. As of June 30, we had 25,757 terminals and 4,034 locations, year-over-year increases of 5.7% and 4.7%, respectively. Location attrition continues to remain low and is mostly attributable to our lowest performing locations closing their doors.

Revenue per location for the quarter in our core states was as follows: Illinois was \$862 per day, an increase of 0.5%. Montana was \$612 per day, an increase of 7.6%. Nevada was \$843 per day, a decrease of 2% and Nebraska was \$255 per day, an increase of 7.6%. The increase in Illinois, Montana and Nebraska was due to a combination of increased player demand, new equipment driving more play and favorable weather. The decline in Nevada was due to an overall increase in supply in the greater Las Vegas locals market.

Capital expenditures for the second quarter were \$18 million cash spend. The increase over the last year was attributable to payments of outstanding invoices from last year. 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 last year and this quarter's elevated CapEx is onetime in nature. For 2024, we are still projecting CapEx to be between \$55 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 our \$40 million of annual depreciation as Andy highlighted earlier.

At the end of the second quarter, we had approximately \$300 million of net debt and \$522 million of liquidity, consisting of \$255 million of cash on our balance sheet, and \$267 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 906,000 shares at an average purchase price of \$10.16 for a total of \$9 million. We are 2/3 of the way through the repurchase program with 12.9 million shares repurchased at a cost of \$133 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 record performance this quarter and excited for what the future holds at Fairmount Park. For the immediate term, we remain focused on executing our growth algorithm, closing the acquisition and getting the casino live. Looking further ahead, we have a strong financial position, demonstrated growth trajectory, improving cash flow profile and strong returns on invested capital. Despite this, we trade at a low double-digit free cash flow yield and a mid-single-digit enterprise value to EBITDA multiple. We look forward to capitalizing on the significant growth opportunities ahead of us as an aligned and incentivized Accel team will move this needle.

Accel remains strong as evidenced by our record second quarter results and our healthy balance sheet. This enables us to pursue a multipronged approach to capital return, making us a compelling investment. Local gaming is an attractive, growing segment within the broader gaming market, with multiple opportunities to generate strong and consistent revenue and EBITDA growth as well as strong free cash flow.

We will now take your questions.

Question and Answer

Operator

[Operator Instructions] The first comes from Steve Pizzella with Deutsche Bank.

Steven Donald Pizzella

Deutsche Bank AG, Research Division

Andy, on the M&A front, you noted the pipeline continues to remain active. Are these similar opportunities to Fairmount in terms of type of assets, size and return profile? And do you have the bandwidth to take on additional projects while working on the Fairmount development?

Andrew Harry Rubenstein

Co-Founder, President, CEO & Director

Thanks for the question, Steve. The -- a lot of the other opportunities that we're looking at are -- they have some resemblance of Fairmount and I say, resemblance. Their local gaming, entertainment type opportunities. Each of them is a little different from each other. Their scale ranges from a few million dollars in an EBITDA upwards into the \$20 million and \$30 million of EBITDA. So I can't say that any 2 or alike, but there's a lot of similarities. And they are able to accentuate our competitive advantages in operating slot machines, working with the local customer and providing value in the entertainment.

As far as the ability to take on more of these opportunities, absolutely. We have a great team. We have great partners all over the country. And you'll see that the opportunities when they present themselves, it's not going to be in one geography because we're pursuing opportunities across the United States and in many of the markets that we already are operating and some that are adjacent or in the region. So there's a lot to look forward to. We're super excited. We're building that skill set to be able to take on more and more, and we've got a great team.

Steven Donald Pizzella

Deutsche Bank AG, Research Division

Okay. Great. And then regarding the Illinois gaming tax increase. Can you talk about anything you can do to offset that? I believe you started talking about TITO. What is the opportunity there?

Andrew Harry Rubenstein

Co-Founder, President, CEO & Director

So as far as the TITO concerned, we believe that TITO will really help facilitate our players in getting more value for their time. They won't be cashing out all the time, they'll be able to continue their play. And historically, in markets where this has been introduced, it provides a lift to the market of about 5% to 10%. So we feel that will help mitigate the 0.5% tax that we increased that we received. And in addition, we really focused some of the bottom part of our portfolio that's maybe not core to our operations. And this tax kind of really allowed us to identify opportunities just to operate in what we call revenue centers and make the overall route more profitable and cut back on some of the expenses for those outlying accounts that at the margin no longer profitable.

Steven Donald Pizzella

Deutsche Bank AG, Research Division

Okay. And just lastly, you noticed a modest same-store declines in Nevada due to some of the increased local supply. Have you seen any changes in demand there at all as we go through July or any green shoots?

Mathew Ellis

Chief Financial Officer

Steve, it's Mat. Thanks for the question. I would say, overall, no, nothing noticeable. It's really just the supply influx that we're seeing. But I think overall, across the business everywhere, including Nevada, you're seeing a real healthy customer for our offering.

Operator

The next question comes from Chad Beynon with Macquarie.

Chad C. Beynon

Macquarie Research

With respect to the new locations in Montana, from a percentage standpoint, certainly some nice growth there. Could you just talk about how that -- how you see that portfolio evolving post the acquisition that you made over a year ago, if there's still new opportunities and if you see that as a big growth market for you guys over the next 12 to 18 months?

Andrew Harry Rubenstein

Co-Founder, President, CEO & Director

Yes. Thanks, Chad. It's Andy. We are excited about Montana. We've found many opportunities in the market to grow our offerings to the establishments. You've seen some new software that we've offered to our existing partners. We've obviously put some new models on the games, which is -- a lot of that has allowed us to win more contracts, we're the premier systems provider in the market, our [AE Rewards] program continues to be the most preferred by players. And as we've identified opportunities for us to test some of our own operations strategy, we've had a few locations that we've opened up ourselves to identify ways to help our existing partners to improve their businesses.

Chad C. Beynon

Macquarie Research

And then post the acquisition, which is coming with the issuance of new stock you still have a significant amount of cash on the balance sheet. So how should we think about, again, in terms of what you need to keep in the company just in terms of working capital, which should be used on an annual basis in terms of share repurchases, Mat, you mentioned that CapEx does come down. So just trying to figure out opportunities in terms of deploying some of this other cash mainly in '25.

Mathew Ellis

Chief Financial Officer

Chad, it's Mat. Thanks for the question. So I think you hit the nail on the head. Free cash flow generation is going to go up. I mean the first deployment for us is always growth as these M&A opportunities come up, we will pursue them. And like Andy said, we have the team for it. We also have the financial capacity for it. So that comes first.

Next would be returning capital to shareholders. We generally want to use our free cash flow to do that because we think that's far more attractive than repaying any debt. So don't want to quite get to an exact number, but if we continue to perform and generate this cash, I would expect our return to capital to shareholders to kind of creep up a bit from where we've been today.

Operator

[Operator Instructions] The next question comes from Greg Gibas with Northland.

Gregory Thomas Gibas

Northland Capital Markets, Research Division

Andy, Mark and Mat. If I could just follow up on some of the dynamics in the quarter. You spoke to the slight Nevada declines being related to increased supply. And on this kind of -- do you expect more supply growth kind of to continue in that market? And then secondly, with the new equipment driving more play, I'm guessing more overall, particularly in Illinois. How long should we expect that to be a tailwind.

Andrew Harry Rubenstein*Co-Founder, President, CEO & Director*

Thanks, Greg. It's Andy. For the Nevada market, the locals market continues to have new supply come on, as you saw Durango happened in late 2023, and there's a lot more new construction coming on. There's -- but at the same time, the Nevada market, especially the Las Vegas market is a growing population. So we think demand will continue. The other macro factors, I don't know how that will impact the local market, but we see a continuance of demand in the near future.

As far as Illinois, there -- if you look at the ratio of slot machines to people or population, we're still underserved in the market on a relative basis. The quality of the equipment that we could -- continue to bring to our customer improves, which basically increases the demand. So we believe that our local convenient offering will always be the most attractive and we see continued growth. The cost of our entertainment is not affected by inflation. So it is a value proposition for dollars that they have for their time.

Gregory Thomas Gibas*Northland Capital Markets, Research Division*

Got it. That's helpful. And if I could follow up on your M&A commentary. Is it fair to say that nothing has really changed from a priority perspective following the recent Fairmount purchase. I guess we shouldn't assume that you're going to be less aggressive in the near term. I just kind of wanted to confirm that your stance on M&A isn't really changing. Is that fair?

Andrew Harry Rubenstein*Co-Founder, President, CEO & Director*

Yes. I would not say we are going to be less aggressive. That's probably not a fair comment. We -- the timing of Fairmount is such that allows us to continue pursuing a lot of these opportunities that we've been working on for the last 12 to 18 months. I think you'll see that we'll continue with finding local gaming opportunities that are within our economics that we have significant liquidity to execute on these. And we have the team to be successful in the local gaming entertainment market. And we're looking forward to showing the investors community that Accel -- and it delivers over and over again.

Gregory Thomas Gibas*Northland Capital Markets, Research Division*

Got it. That's helpful. And Congrats.

Andrew Harry Rubenstein*Co-Founder, President, CEO & Director*

Thank you.

Operator

There are currently no other questions in queue. [Operator Instructions] With no question remaining at this time. I will pass it back over to Andy Rubenstein for closing remarks.

Andrew Harry Rubenstein*Co-Founder, President, CEO & Director*

Thank you. I just wanted to -- thank you, everyone, for joining us today. A few weeks ago when we announced the Fairmount transaction. We're looking forward to sharing an update on that on the next earnings call. I think you'll see that the direction Accel is going is exciting and Fairmount is the beginning of a new trajectory where Accel will continue growing in markets across the United States. So enjoy the summer, and we'll see you again in the fall. Thanks.

Operator

This concludes the conference call. Thank you for your participation. You may now disconnect your lines.

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