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Accel Entertainment, Inc. (ACEL)

Q3 2020 Earnings Call

CORPORATE PARTICIPANTS

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Brian Carroll

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OTHER PARTICIPANTS

Greg Gibas

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Steven Pizzella

Analyst, Deutsche Bank

William Ketelhut

Analyst, Goldman Sachs & Co. LLC

John DeCree

Analyst, Union Gaming Research LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Accel Entertainment Q3 2020 Earnings Call. At this time, all lines have been placed on mute to prevent any background noise. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Thank you.

At this time I would like to hand the call over to your speaker today, Mathew Ellis, SVP of Corporate Strategy. You may begin, sir.

Mathew Ellis

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

Welcome to Accel Entertainment's third quarter 2020 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 and the current health concerns. 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.

Thank you, [ph] Matt (00:02:07). Good morning, everyone. Thank you for joining us for Accel's third quarter 2020 earnings call. As everyone is aware, after three and a half months of shutdown, video gaming re-launched on July 1. The Accel team rose to the challenge and worked with our location partners to reopen as many locations as possible. As a result of these efforts, I'm pleased to report this quarter was the highest revenue and adjusted EBITDA quarter in Accel's history.

Later in the call, I will provide an update with respect to pandemic developments, but I would first like to review some other highlights from the quarter. In July, we redeemed the Pace Public Warrants, and in August, we completed an exchange offer of all remaining warrants. As a result, less than 0.03% of the warrants remain outstanding today.

This redemption and exchange offer simplified our capital structure and reduced the potential dilutive impact of the warrants. In early September, we entered into an exclusive agreement with DraftKings to promote their content and programming across all our marketing channels, including our in locations digital display screens.

This first of its kind collaboration further differentiates our offering and deepens our player relationships. This partnership will help us retain and extend agreements with existing locations, attract new organic and competitor locations, and most importantly, drive additional players to our locations. While we are still evaluating the benefits of this partnership, initial results have been positive.

Finally, in late September, we completed an underwritten public offering of 9.1 million shares. The offering raised approximately \$90 million which we expect to deploy in the next nine months. Our M&A pipeline remains active and we aim to continue executing on our growth strategy. For the third quarter, we recorded \$136 million in revenue and \$23 million in adjusted EBITDA. Our balance sheet remains strong with net debt of approximately \$140 million and total liquidity of \$274 million. Accel was extremely well positioned to capitalize on any opportunities that may arise in the coming months.

With that, I'm going to turn it over to Brian Carroll, our CFO to walk you through the third quarter results in more detail.

Brian Carroll

Chief Financial Officer, Accel Entertainment, Inc.

Thank you, Andy. As of September 30, we had 11,597 VGTs and 2,363 locations, year-over-year increases of 12% and 3% respectively. The increase in locations demonstrates that while we are operating in a new and normal environment, Accel continues to grow. The IGB has resumed their meetings and our sales teams continue to sign new organic and competitive locations.

In addition, our attrition rate on closures remains in-line with the pre-COVID historical average. At the end of September, our average residual contract length was approximately 6.9 years on a standalone basis and also 6.9 years including the Grand River acquisition. As a reminder, the Grand River locations originally had an average residual contract length of 5.8 years. The closing of this gap demonstrates our ability to successfully integrate the locations and extend their agreements. We've installed more than 806 VGTs and expect to install a total of 1,000

by year end. Originally, we expected to be able to update 50% of our VGTs remotely to the higher bet limits software and 50% via an on-site update. During the remote update process, it was determined approximately 25% of the remotely updatable VGTs will now require an on-site update. It's important to note this issue affected the entire industry not just Accel.

Today, approximately 50% of all VGTs have been updated to a higher bet limit software. We continue to perform on-site updates every day, but based on current software availability, we now expect to complete the update by June of next year. We had total revenue for the third quarter of \$136 million, the highest revenue quarter in Accel's history. Our combined third quarter location hold-per-day was \$596, a year-over-year increase of 4%. It's important to remember, Grand River was acquired on September 16, 2019, meaning those locations were included for all Q3, 2020 but only 15 days of Q3, 2019. Excluding the Grand River acquisition, our location hold-per-day was \$649, a year-over-year increase of 11%.

Adjusted EBITDA was \$23 million, another record for itself. As a reminder, the Illinois VGT tax increased from 33% to 34% on July 1. CapEx was \$13.5 million cash spend in the third quarter compared to \$9.3 million in the third quarter of 2019. The increase was largely attributed to vendors that allowed us to defer payments during the second quarter. At the end of the third quarter, we had approximate \$140 million in net debt and \$234 million of liquidity consisting of \$179 million of cash on our balance sheet and \$95 million of revolver availability.

Back to you Andy.

Andrew H. Rubenstein

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

Thank you, Brian. I now like to discuss the COVID-19 situation in Illinois. As of July 1st in connection with the re-launch, VGTs are required to be spaced six feet apart or to be separated by partitions. Players must wear masks in the gaming area and PPE is provided to the players. These precautions have ensured VGTs could be played safely. Returning player response has been positive as demonstrated by our revenue. In July, Governor Pritzker divided Illinois into 11 regions. As of November 4th, all regions were operating with mitigation measures which include a prohibition on indoor dining.

VGTs are available for play from 8:00 AM to 11:00 PM. Despite the reduced hours, Accel has only seen a minimal impact to net video gaming revenue, but continues to monitor the situation closely. Our October revenue will be published by the IGB in the coming weeks which will reveal Accel had another positive month. To wrap things up, I'm extremely pleased with our record third quarter performance, demonstrating the resiliency of Accel and our industry. The Accel team members continue to overcome the current challenges while delivering industry leading customer service.

We will now take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from line of Greg Gibas. Your line is open.

Greg Gibas

Analyst, Northland Securities, Inc.

Morning, guys. Thanks for taking the questions and congrats on the record results. Good to see. I was just wondering if you could give a sense of how much of your operating expenses in the quarter were maybe one-time in nature just kind of due to getting all your locations up and running again with the new protocol and dividers?

Brian Carroll

Chief Financial Officer, Accel Entertainment, Inc.

Yes. This is, Brian. The CapEx was approximately over \$2 million that was spent on the dividers. With regard to one-time operating expenses, we – they are included in our numbers. The only time we've adjusted EBITDA for COVID was related to primarily if we have – when we furloughed employees and paying benefits and retention bonuses and so forth like that. So, but the – just to give you an idea on a monthly basis right now, COVID is probably costing us probably a little over \$100,000 a month in operating.

Greg Gibas

Analyst, Northland Securities, Inc.

Got it. Okay. Thanks for clearing that up. Appreciate that. And then regarding the VGTs that have been updated with the new software for the higher betting limits, have you noticed an incremental uplift, I guess, in revenues from those machines, even though, I think you said it was only 50% or so have been updated so far?

Andrew H. Rubenstein

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

Yeah. I mean, it's provided a lift in our overall revenue per location. So whether it's from more selection or more opportunity for people to play, we can't really discern what specific driver. But it does – it has helped us raise the overall location revenue.

Greg Gibas

Analyst, Northland Securities, Inc.

Okay, great. I guess last one from me just considering we saw those three strong months in the quarter, across the state, I guess I was wondering if you could comment on anything or share anything in relation to how gaming activities trended in October relative to those previous months and then maybe how you expect the IGB's decision to kind of limit hours of play, how you think that will affect Q4?

Andrew H. Rubenstein

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

October was a very positive month. And the actual numbers should be published in the next 10 days to 12 days. But we have seen some affect, although it's minimal from the limitation of the hours, but it's really early to make any definitive assessment.

Greg Gibas

Analyst, Northland Securities, Inc.

Sure. Okay. Thank you.

Q

Operator: Your next question comes from the line of Bill Ketelhut of Goldman Sachs. Your line is open.

William Ketelhut

Analyst, Goldman Sachs & Co. LLC

Hi. Thanks for taking my question. And I was wondering if you could give us a sense of what you're hearing from your – from the locations that you work with and whether any recent restrictions are going to lead to maybe incremental financial distress or more churn?

Q

Andrew H. Rubenstein

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

I would tell you that if I own a restaurant bar and I can't sell food or beverage indoors and then the temperature is 20 degrees outside, it's going to impact me. So there is going to be some impact on our business. We've seen a little of that, when we had a little cold stretch in the last couple weeks. The question is like how long the mitigations last and how they become – and how they're eased. Yesterday, the governor indicated that he was going to evaluate things in the next couple weeks. So, we're hopeful that they'll allow some indoor consumption and once even some occurs, I think the overall effect will be really minimal.

A

William Ketelhut

Analyst, Goldman Sachs & Co. LLC

That's helpful. Thank you. And I guess kind of more on an unrelated note. There seems to be a kind of a lot of moving parts to free cash flow given the acquisition of Tom's Amusements and I know you're buying terminals kind of on a forward basis. Could you just give us a sense on what free cash flow conversion as a percentage of EBITDA should be like on a normalized environment, maybe [ph] X (00:14:32) all those growth investments?

Q

Brian Carroll

Chief Financial Officer, Accel Entertainment, Inc.

I can give you – this is Brian – I can give you some ranges. Say for example [ph] on our current (00:14:40) what you've seen in Q3, probably free cash flow is about approximately amounts \$6 million. You then have to deduct CapEx, but keep in mind, most of our CapEx is for growth purposes. To refresh maintenance CapEx runs us maybe \$2 million to \$3 million on a given year. So with that in mind, you have your – what you've seen in Q3 of approximately \$6 million a month of free cash flow, less however we spend for growth CapEx purchasing equipment. And that could be about, I'd say on the average about \$2 million to \$2.5 million per month.

A

William Ketelhut

Analyst, Goldman Sachs & Co. LLC

Got it. Thank you. And I guess one last one, I'll sneak in here if I can, is there anything that you've kind of learned as you spent more time in Georgia over last quarter?

Q

Andrew H. Rubenstein

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

A

Oh. I say that the major lesson learned there is that we're going to have to be very prudent in choosing our business partners as there is a wide range of companies and operations and some of them are more attractive to partner with, and especially as a public company, we need to protect our brand and the ethics that we run our business. And there is individuals there that don't seem to be concerned about running a business with integrity.

William Ketelhut

Analyst, Goldman Sachs & Co. LLC

Great. Thank you. That's it for me.

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

Steven Pizzella

Analyst, Deutsche Bank

Hey, guys. Thanks for taking my questions. Can you just talk about any insights that you might have to the type of customers you are seeing on your locations relative pre-pandemic visitation? We have heard from some of the regional gaming operators that they have been seeing a younger customer. I just wanted to see if that aligns with what you are seeing also?

Andrew H. Rubenstein

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

I wouldn't say it's necessarily a younger customer, we're seeing some younger players. And there are obviously some older players that are less comfortable going out. But you got to remember like our portfolio is so diversified geographically throughout the state that the kind of feelings or reaction to the COVID restrictions are very different depending on where you live. And so we're not seeing any major trend, but there is some individuals that who are elderly that don't feel comfortable. And then for some of the younger individuals who may have gone to a casino where – or gone to the movies or done some other activity, those players have trended towards us and we're getting more of that visitation.

Steven Pizzella

Analyst, Deutsche Bank

Okay. Great. Thanks. And then just wanted to follow-up on the DraftKings deal, can you just kind of talk us through the benefit that you received from it in any economics you could actually share on it?

Andrew H. Rubenstein

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

So, there's been – as far as benefits, we've seen a few of our competitor locations decide that they wanted to move their business over to Accel when their contracts have finished because we're offering a benefit that's unique in this marketplace. So we've seen that, we're going to get some new customers. People also are opening up new establishments that want to have that feature for their guests.

Financially, we today don't have a revenue share as we don't have a license for sports betting. But we are an affiliate and are receiving compensation from DraftKings as we're getting a lot of sign up players, and that benefits being shared with the establishments that the player signs up at. So, [ph] what they acknowledge (00:19:49) – that they – kind of got the information. So, it's very early to measure that, but we have got a fairly significant

amount of sign-ups since we kicked this off and DraftKings is, I would guess, doing well in the state of Illinois in terms of player acquisition and player communication and we were a form of that communication.

Steven Pizzella

Analyst, Deutsche Bank

Q

Okay. Great. Appreciate it. Thanks, guys.

Operator: Our next question is from line of John DeCree of Union Gaming. Your line is open.

John DeCree

Analyst, Union Gaming Research LLC

Q

Hi, everyone. Thank you for taking my questions. Andy – I guess the first one is for you perhaps – and then a follow up maybe for Brian. And, I'm not sure if you've added any more color, but with the equity raise in the quarter and adding some cash to the balance sheet, I think in your prepared remarks, you mentioned about possibly deploying that over the next nine months or so, and just wondering if you could give us any kind of more color or guidelines as to where you'd be looking or prefer to spend that capital. Would it be more likely in Illinois or something like you did with Tom's, perhaps in Georgia or in another state, just kind of getting your sense of capital properties?

Andrew H. Rubenstein

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

A

There's a lot of opportunities. There's still some significant things that we're working on in Illinois. And as we have the focus to explore in the new markets and really establish ourselves, those opportunities are also presenting themselves. So, I think you'll see us move in a couple different directions and hopefully 2021 will be a pretty acquisitive year.

John DeCree

Analyst, Union Gaming Research LLC

Q

Thanks, Andy. That's helpful. And Brian, perhaps for you, with additional liquidity on the balance sheet, your leverage ratio comes down quite a bit and I think kind of anticipating some growth capital being deployed in 2021 as Andy had just discussed. Where do you feel the right kind of leverage ratio is for Accel kind of right now, kind of with gross capital deployed [indiscernible] (00:22:33) preserve range that you guys feel comfortable with and want to be in?

Brian Carroll

Chief Financial Officer, Accel Entertainment, Inc.

A

Hi. Yes, John. I mean more recently, just a little bit of disruptions, we're as high as around 4%. And typically we might get obviously [ph] we're delivering (00:22:53) back. Historically, we've always been comfortable around the 2 to 3 range and then we would lever up if we did an acquisition and then kind of fall back down pretty quickly because of our free cash flow. And – but right now, like I said, we're below 4. And so it's kind of a – historically since we've been in business, we've done it that way. So, typically once everything [ph] levels up (00:23:18), we're still pretty comfortable for around 2 to 3. Did I answer your question?

John DeCree

Analyst, Union Gaming Research LLC

Q

Thanks for that. It does. That's perfect. Thanks, guys.

Operator: There are no further questions over the phone lines at the time, I turn the call back to Andy Rubenstein.

Andrew H. Rubenstein

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

Just wanted to thank everyone for listening today. Hopefully, the mitigation from our governor will be modified and reduced in the coming weeks and for all of you that live in Illinois and around the country, please continue to wear your masks because that will only help our industry as well as to mitigate the effects of the COVID environment. Have a good day. Thank you.

Operator: This concludes today's conference call. You may now disconnect.

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