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Accel Entertainment, Inc. (ACEL)

Q3 2022 Earnings Call

CORPORATE PARTICIPANTS

Derek Harmer

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

Mathew Ellis

Chief Financial Officer, Accel Entertainment, Inc.

Andrew H. Rubenstein

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

OTHER PARTICIPANTS

Omer N. Sander

Analyst, JPMorgan Securities LLC

Greg Gibas

Analyst, Northland Securities, Inc.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for your patience and thank you for attending today's Accel Entertainment Third Quarter 2022 Earnings Call. My name is Amber, and I will be your moderator for today's call. All lines will be muted during the presentation portion of the call with an opportunity for questions and answers at the end. [Operator Instructions]

It is now my pleasure to hand the conference over to our host Derek Harmer with Accel. Derek, please proceed.

Derek Harmer

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

Welcome to Accel Entertainment's third 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

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

Thanks, Derek, and good afternoon, everyone. Thank you for joining us for Accel's third quarter earnings call. I'm pleased to report we had another strong quarter. We reported revenue of \$267 million, a year-over-year increase of 38%, and adjusted EBITDA of \$41 million, a [ph] year-over (02:28) increase of 9%. Q3's revenue growth was primarily driven by the successful acquisition of Century and 3% same-store sales growth in Illinois. Adjusted EBITDA had a lower growth rate than revenue due to Century's negotiated splits.

Despite the current inflationary environment, our performance continues to demonstrate the strength and resilience of our business model. We believe businesses will continue to see the upside of local gaming in their establishments that they will continue to invest in their gaming due to the incremental profits they receive and that players will continue to choose our local high-quality offering due to its convenience and appeal.

On the expense side, we continue to invest in new market opportunities and also face higher than expected costs from macroeconomic-related impacts, such as increased labor, parts and fuel expenses. Our partnership with local establishments is what drove our success for the last 10 years. It what sets us apart from the competition today and we will continue to refine how we win in an environment of increased cost pressures.

Our asset-light business model and highly variable cost structure allows us to quickly adjust. With Century on board, we're starting to explore new growth opportunities and implementing some cost savings initiatives. Century continues to outperform our original expectations and the integration remains on schedule. We believe that Century's technological capabilities will provide us with a competitive advantage in some of the developing markets where we currently operate or plan to operate in the near future.

In Nebraska, I'm excited to share we closed two acquisitions. In August, we purchased VVS, an amusement operator based in Lincoln, and in September, we purchased River City Amusements (sic) [Amusement] (04:31), based in Sioux City. While Nebraska's play is significantly lower than our more established markets, we remain optimistic about the potential of the market. We aim to continue growing Nebraska both organically and through acquisition. Overall, our M&A pipeline remains active and we are evaluating multiple opportunities 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 Lottery announced it would be expanding its Gift Card Pilot Program by making it available to all locations. This program allows players to load their winnings onto a prepaid value card, which substantially reduces one of the biggest barriers players face in the Georgia market. We're working with the value card provider selected by the Lottery and expect the rollout to begin this quarter.

We see this as an opportunity to expand our presence in the market and the profitability of each location. Overall, Accel continues to execute its growth playbook. We remain excited about the opportunities in the markets where we currently operate as well as the new markets we're looking to enter. 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 afternoon, everyone. For the third quarter, we had total revenue of \$267 million, a year-over-year increase of 38%, and adjusted EBITDA of \$41 million, a year-over-year increase of 9%. I would like to remind everyone that Century has been included in our results since June 1 and 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 increased 3% year-over-year confirming demand for our offering remains strong. CapEx for the third quarter was \$20 million cash spent. The noticeable increase is due to our investment in the Nebraska market and the partial acceleration of planned 2023 CapEx due to potential supply chain disruptions. As of September 30, we had 22,429 terminals in 3,517 locations, year-over-year increases of 68% and 38%, respectively. Location attrition continues to remain low and in line with our historical averages.

At the end of the third quarter, we had approximately \$309 million in net debt and \$567 million of liquidity, consisting of \$212 million of cash on our balance sheet and \$355 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 \$22 million of Accel stock at an average purchase price of \$10.01 a share. Since the program started, we have repurchased nearly \$80 million of Accel stock through the end of October. Given our relatively under-levered balance sheet and strong free cash flow, we are in a position to make exciting investments like Nebraska, while continuing to appropriately return capital to shareholders.

To wrap things up, I'm pleased to report that we are reaffirming our previously disclosed guidance for locations, gaming terminals, revenue and adjusted EBITDA. CapEx guidance has increased due to our investment in the Nebraska market and the acceleration of some planned 2023 CapEx due to potential supply chain disruptions. As a reminder, we expect to end 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. Adjusted EBITDA is estimated to be \$160 million to \$165 million. CapEx is now estimated to be \$38 million to \$43 million cash spend.

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

Andrew H. Rubenstein

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

Thanks, Mat. We're pleased with another strong quarter and remain focused on executing our growth strategy, leveraging the strong foundation we have built and our proven playbook. We're confident 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 strong financial position to continue our expansion and to continue to return capital to shareholders.

We will now take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the Q&A session. [Operator Instructions] Our first question comes from Omer Sander with JPMorgan. Omer, your line is now open.

Omer N. Sander

Analyst, JPMorgan Securities LLC

Hey, Andy, Mat. Good evening. Thanks for taking my question. On the 2Q call, you talked about the backlog in Illinois being up mid-teens or still your day. Two questions within that. Where does that stand today? And also a question about how you think about that number when you look at this backlog and compare it to the historical pace of licenses awarded your historical or normalized, call it, 100, 150 net locations added, maybe 200 or so – 250 gross or so. Hypothetically, assuming this backlog stop being sold tomorrow, obviously, hypothetical, how long would that last [ph] here? (10:58)

Mathew Ellis

Chief Financial Officer, Accel Entertainment, Inc.

Hey, Omer. This is Mat. I'll take the first part of the question, and I'll give the second part to Andy. So on the backlog front, it does continue to grow. We continue building it up and licensing is coming as quickly as we can. We continue to work to get as many locations live as quickly as possible. But the good news is we continue building those logs and again, we don't just look at the raw count, but we look at the quality of those locations and it continues to be consistent with what we've previously signed. On that, let me turn it over to Andy on the second part.

Andrew H. Rubenstein

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

Thanks, Omer. As we look at how the backlog builds, it will always continue to build, because the Darwinism that occurs where locations fail and then new people open up their establishments or their business in those old locations. Also, there's always a continual kind of new business opening. So we'll always have a – some type of a backlog that's building.

Now, using that assumption, let's assume that there's no other additional sales opportunities, the current backlog would continue without any – would continue to provide new locations without any break in licensing, because it takes nearly nine months for – from the time a location applies to where it goes live. So we wouldn't feel any difference in our licensing for, at least, nine months and then it would slowly kind of decline for probably the next 24 months. So there's a time period where, yes, if there was no more licensing that there would be a decline, but it would take about nine months to fill it.

Omer N. Sander

Analyst, JPMorgan Securities LLC

Awesome. Thank you. That's helpful.

Operator: Thank you. Our next question comes from the line of Steve Pizzella with Deutsche Bank. Steve, your line is now open.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Good evening, guys. Just wanted to focus in on the guidance or where it implies for 4Q, I believe, kind of to get to the midpoint, it's around 5% or 6% sequential growth. Can you talk about the drivers of that, given some of the moving parts? Is there some seasonality there, kind of a ramp-up in Century, kind of what gets you to the midpoint of the guide? Thanks.

Mathew Ellis

Chief Financial Officer, Accel Entertainment, Inc.

A

Hey, Steve. It's Mat. Thanks for the question. The seasonality will be the key thing. As we sort of saw, the summer is a slower period of time. We saw a nice ramp-up in September, October even looked better. So what's going to get us there is again as we get into the colder weather and just the general seasonality, we do well around the holidays. We should have a nice pickup as compared to sort of those slower summer months that you see in Q3.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thanks. And then, now that you've had Century for a few months now, can you kind of talk about some of the takeaways you've had? And then, I think locations grew about four or five quarter-over-quarter. Can you talk about how we should think about location growth in Montana and Nevada moving forward? Thanks.

Andrew H. Rubenstein

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

A

Thanks, Steve. This is Andy. As we've begun working with the Century team, we've seen a lot of opportunities to grow the business. They have really identified areas within Montana, a few within Nevada where there – where they hadn't pursued new locations in the past due to capital constraints that we can really look at. And I think, you'll see a slow ramp-up over the next 6 to 12 months where there will be a growth that they haven't seen in the past. And we're excited for what Century brings to the overall Accel portfolio. And as we implement some of our strategies that we've been successful in Illinois, I see I think they'll benefit from that, both the Montana and Nevada markets.

Steven Pizzella

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Appreciate it. Thanks, guys.

Operator: Thank you. Our next question comes from the line of Chad Beynon with Macquarie. Chad, your line is now open.

Q

Hi. This is [ph] Sam (16:07) on for Chad. Thanks for taking our questions. Just had a couple of questions. First one, could you guys provide any color on margins, how we should think about modeling that going forward and perhaps if you see any opportunities to drive more profitability with the Century acquisition now that you've been operating in Nevada and Montana for a few months?

Mathew Ellis

Chief Financial Officer, Accel Entertainment, Inc.

A

Sure, [ph] Sam. (16:31) This is Mat. Thanks for the question. I'll kind of bifurcate this. On the Century side, as Andy talked about, we're starting to see some opportunities to grow sort of revenue there, and we should naturally see a slight pickup in margins. It's going to take time. Again, these are mature markets. But if you think back in the short term, again, we're still grasping everything. But as we slowly implement some new initiatives, you should see a very modest pickup in margins there.

On the Illinois side, you've got two things going. Illinois continues to grow, but we also have most of our corporate folks here that are staffing for more than just Illinois and Century, but just our continued growth playbook. We talked about growth in Illinois. They are also – excuse me – we talked about growth in Nebraska. There's also some corporate support from Illinois helping that.

So, overall, on the Illinois market at this point, we should start seeing some nice operating leverages. Adding Illinois location to our base requires minimal expense. That will take some time to come through. On the other side, we're still heavily invested in growth to support the new sort of developing markets that we're looking at, Georgia, Nebraska and, hopefully, some other once in the near future.

Q

Got you. Thank you for that. And for the second question, could you provide any color on consumer trends that you're seeing into October and if there's been any variance in the three segments?

Andrew H. Rubenstein

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

A

Yeah. This is Andy. I – as we – I've been looking at this constantly. And as we see overall trends that are going on in the macro economy, they really haven't affected our business, yet today, we're hyper aware of it. And we're looking for indications that there may be some softness, but it hasn't shown through in our immediate markets yet.

Q

Awesome. Good to hear. Thank you.

Operator: Thank you. There are currently no further questions in queue. [Operator Instructions] Our next question comes from Greg Gibas with Northland. Greg, your line is now open.

Greg Gibas

Analyst, Northland Securities, Inc.

Q

Great. Thanks for taking the questions. I guess I just – most were answered – wanted to follow up on kind of the M&A strategy and maybe what your priorities are in terms of markets? Is – with the recent movement in Nebraska, is that maybe number one in terms of new markets, or are you looking at new states, any comments there would be helpful?

Andrew H. Rubenstein

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

A

Yeah. Thanks, Greg. This is Andy. The new markets are always a lot of our focus. We've been successful entering the Nebraska market. We continue to look at it and work on developing the businesses that we've already acquired. As far as other markets, it is a constant focus of ours to explore some of these opportunities. We have – we've explored some of the opportunities in markets like Georgia and Montana and Nevada in the past. We'll look in those markets as well. I think if legislation passes in the spring, obviously, that will be a major focus of ours. So our eyes are always open. We're open to ideas. And I think you can expect us to continue pursuing M&A activity going forward.

Greg Gibas

Analyst, Northland Securities, Inc.

Q

Okay. Makes sense. And could you maybe remind us on the gross margin differences from Century versus maybe the core Accel operations in Illinois?

Mathew Ellis

Chief Financial Officer, Accel Entertainment, Inc.

A

Sure. Greg, this is Mat. I'll take that one. So, Illinois, you know it's a predetermined split, we roughly receive just under like 32.5% of the revenue. In the Century market, it's negotiated. So, obviously, it's different with everything. But if you think back to some of the 8-Ks we put out earlier, somewhere in the neighborhood of 75%, 80% of the revenue is going to the locations and the remainder to Century.

Greg Gibas

Analyst, Northland Securities, Inc.

Q

Okay. Makes sense. Thanks, Andy and Mat.

Operator: Thank you. There are currently no further questions left in queue, so I will pass the conference back over to Andy for any additional or closing remarks.

Andrew H. Rubenstein

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

I just wanted to thank everyone for taking their time today to hear the third quarter results. We look forward to finishing the year in a very strong way, and I want to wish everyone a good holiday season and we'll talk to you again come springtime. Thank you.

Operator: This concludes today's Accel Entertainment third quarter 2022 earnings call. Thank you for your participation. You may now disconnect your line.

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