## Introduction:

At Manole Capital, we exclusively focus on the emerging FINTECH industry. We intentionally maintain a very broad definition of FINTECH and believe it is "anything utilizing technology to improve an established process". For us, the payment sector is the quintessential FINTECH business, as it is a secularly growing sector that has businesses that generate sustainable and predictable free cash flow. Within the payment sector, we favor businesses that generate recurring revenue or ***revenue per swipe***, as opposed to one-time sales. Another interesting area we classify as FINTECH are "data & information" companies. While there are new businesses in both segments coming to market each year, many of our holdings have been capitalizing on their dominant franchise for decades.

Our loyal readers know that we absolutely love sports at Manole Capital and often quote legendary coaches and players in our newsletters. There are so many parallels between the competitive nature of sports and successful investing. Along those lines, we thought we would attempt to write a research note on a recently IPO'd company, that hits on our version or theme of FINTECH. The company we plan on reviewing is Draft Kings (ticker DKNG).

Throughout this note, we will use its ticker, DKNG, instead of writing out Draft Kings. Before you jump to the conclusion that DKNG is not a valid FINTECH company, let us explain. We have several names in our portfolio that most would never consider FINTECH companies. For example, the derivative exchanges have shifted from open outcry and pit trading (seen here) to nearly 100% electronic trading venues. Using our definition of FINTECH, these companies are "utilizing technology to improve an established process".

Historically, if one wanted to gamble, a trip to Las Vegas or Atlantic City was necessary. Visiting a beautiful, multi-billion hotel is great, but it can present a problem for the operator. That entity can spend $3 or $3 billion building a beautiful hotel and casino on the Las Vegas strip. Then, it needs to fill those rooms and attract gamblers to its casino. The operating costs of a hotel can be high, plus there's no guarantee that gamblers will lose in your casino. Many of these casinos target "whales" and entice them to gamble in their casino by flying them to the hotel, giving free food and alcohol and then ensuring they can gamble in a "high end" environment. The problem is, there is no guarantee that these costs will lead to profits, as gamblers sometimes win, right? One of the nice things about the new online and mobile model we are about to discuss, is that they are everything but the hotel operator. Without that costly presence in Las Vegas, these companies are "utilizing technology to improve an established process."

Now that we have identified DKNG as a possible FINTECH company, we need to do a deeper dive into its business and its underlying fundamentals. We will start with a quick review of fantasy sports, gambling, and PAPSA. Then we will attempt to frame the estimated market opportunity, in DFS (daily fantasy sports), OSB (online sportsbook) and iGaming. Lastly, we will try to estimate future results and arrive at a reasonable 1 to 2 year forward valuation.

## Travel:

In 2019, over 42.5 million people visited Las Vegas and a Statista survey found that it is the 2nd most popular destination in the US. Nevada, New Jersey and Macau were structured to benefit from two key areas. Their luxurious facilities were built for individuals to be pampered, fed and entertained. Quite simply, the massive casinos inside were built for gamblers to lose money.

In a pre-COVID-19 environment, people loved to visit "Sin City" and stay at great hotels, eat wonderful food, see different live shows and gamble. However, everything changes when travel is restricted due to a global pandemic. Casino operator Wynn Resorts (Wynn, Encore in Las Vegas, Encore Boston Harbor in Massachusetts and resorts in Macau) recently reported 2nd quarter 2020 results. Unfortunately, Wynn's revenue fell by 95% and that it lost $523 million.

Over the last two to three years, the amount of interest and competition in gambling has dramatically risen. Every casino in the world is struggling to drive traffic and revenue in a COVID-19 environment. The opportunity to increase revenue by leveraging their brand is probably at the top of each casino's "to do" list.

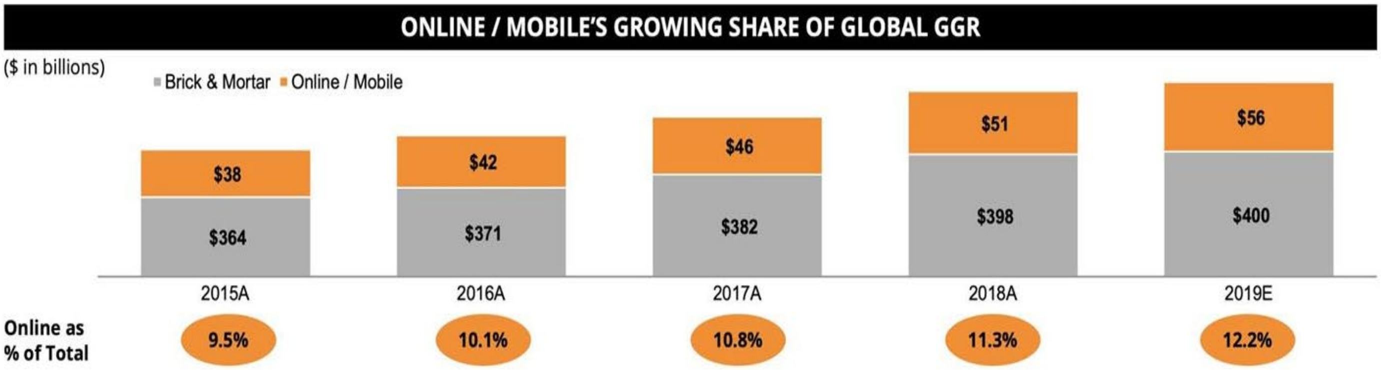
In the US, the casino sector has experienced a major shifted. Over the last several decades, Atlantic City lost ground to Las Vegas and Connecticut. As additional states have added casino gambling (Pennsylvania and others), the draw to Nevada has waned. Also, the US has lost material market share to Macao. Macao, as the "Las Vegas of Asia", has not only eclipsed the revenue and traffic generated in the US, but it has tripled it. In 2019, Macao's casinos generated $36.7 billion in gross revenue, as compared to Las Vegas of $11.9 billion.

## Smartphones Are The Opportunity:

As we indicated above, we believe that the market opportunity for gambling (in various forms) is strong in the US, but maybe even stronger outside of the US. However, each country has specific tastes, as well as stringent rules and regulations regarding gambling. For this note, we will primarily be focused on the US market, across the entire gambling ecosystem.

We believe that there is a seismic change occurring between brick and mortar, physical locations versus online and mobile technology. COVID-19 restrictions have only increased the opportunity for mobile gambling. There are so many businesses, across multiple industries (restaurants, travel, retail, etc), that have been negatively impacted by COVID-19. However, we think there are a few industries that can be considered beneficiaries of this terrible environment. For example, we think eCommerce will continue to steal market share from traditional retailers. We also believe that digital forms of payment (contactless, card, mobile, etc) will continue to gain market share from cash.

If one looks at the global GGR, the vast majority of revenue (over 87% of the total) is still generated at physical casinos. However, online and mobile-based gaming is steadily gaining market share and growing. As the chart below indicates, online and mobile GGR, as a percentage of the total, has grown from 9.5% in 2015 to 12.2% in 2019.




New Jersey was the first state to legalize sports betting and it determined that over 80% of its volume came from online and mobile phones. Clearly, one's smartphone is an easier format for placing bets than calling a "bookie" over the phone. We will attempt to layout the case for continued market share gains for online and mobile gaming. Using baseball as the first of our many sports analogies, we'd put this share shift in the 2nd or 3rd inning of a baseball game We feel that online and mobile gaming is a secular growth industry and it should approach 15% to 20% of total GGR, over the next several years.

## You're Never Going to be a GM or Team Owner:

We wanted to start our analysis with something fairly obvious. We are sorry to say, but you probably don't have the capital to ever become a sports team owner. While you can purchase a share or two of the Atlanta Braves (ticker BATRA) or Manchester United (ticker MANU), this ownership will not give you any ability to impact how they are run.

When the Los Angeles Dodgers (MLB) sold for a record $2 billion in March of 2012, the media said it was unsustainable. When ex-Microsoft CEO Steve Balmer paid $2 billion for the Los Angeles Clippers (NBA) in May 2014, the media said it was a "crazy valuation". According to Forbes, the Dallas Cowboys have been the most valuable NFL franchise for the last 13 years. Jerry Jones purchased the iconic team for $140 million in February 1989, and it is now estimated to be worth $5.5 billion. If the average NFL team makes over $100 million in operating income each year, the valuations should continue to grow. As of 2020, the average NFL team value is $2.9 billion; the latest transaction coming from billionaire hedge fund manager David Tepper, paying $2.3 billion for the Carolina Panthers in 2018.

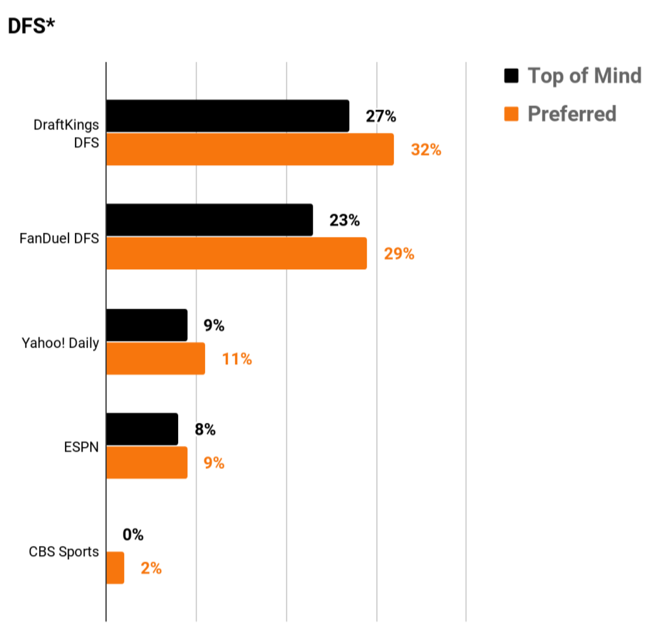
TV ratings have been in decline for years, but televised live sports continue to be the most attractive category for the major networks to acquire. Every 5 to 10 years, the right to televise certain sporting events come due. At each of these occasions, the networks pay enormous sums of money for the right to televise these live events. The NFL's focus is to reach $25 billion in revenue by the year 2025 and this number seems very achievable. The NFL reaps roughly $5 billion a year from its TV contracts with CBS, NBC, Fox and ESPN. When these contracts expire in 2021 to 2022, we expect yet another increase from those eye-popping levels.

Statista examines sports league revenues and estimated that the 32 teams in the NFL average over $450 million in revenue per year. However, professional football is not the only sport generating huge sums of revenue from TV. Forbes estimated that Major League Baseball or MLB's 30 teams generated over $350 million a year in revenue in 2019. Rounding out the US's Top 3 professional leagues, Statista estimated that the NBA's 30 teams will achieve average revenue of nearly $300 million per year. With broadcasting rights rising and generating large pools of revenue for teams and leagues, prices of franchises should remain high. To state the obvious, these revenues have led to lofty purchase prices.

## DFS:

So, you cannot buy your own franchise, but you can pretend to be that GM or team owner by participating in a DFS (daily fantasy sports) league. In terms of market share, as this chart shows, DKNG is the preferred DFS league and dominant platform.

Over the last decade or so, the interest in fantasy sports has skyrocketed. According to the Fantasy Sports & Gaming Association, over 60 million play fantasy football each year, spending an average of over $550 per year on league dues and online entry fees. Fantasy sports have also had a positive impact on all the major sports leagues, significantly increasing interest, leading to higher revenues. Anything that generates over $7 billion a year in revenue and continues to post double-digit annual growth is going to attract a lot of attention.




Manole Capital is always looking for companies to own that have certain attractive characteristics. For example, we love for our companies to be market share leaders (what Warren Buffett calls a "moat around the franchise"), sustainable business models, free cash flow generative businesses, strong balance sheets and management teams that rationally allocate our capital.

When one analyzes "top of mind", one measurement can be the average number of minutes spent per session (called MPS). Using comScore monthly data, from January 2019 to January 2020, DKNG was the leader at 6.5 minutes per session. FanDuel was 2nd at 5.1, with traditional sports websites like ESPN, CBS Sports, Barstool, and Bleacher Report getting 4.2, 3.5, 2.7 and 2.2 respectively.

DFS are often considered "contests", not true gambling. While most participate in annual fantasy leagues (among friends), there is growing popularity in daily or weekly contests between thousands of different participants. These contests can be quite lucrative, with some awarding over $1 million to the winner. For running fantasy leagues and contests, the long-term revenue opportunity is maybe a couple hundred million DKNG sports a large valuation.

We believe that most industry participants model a strong cross sell between starting with DFS and migrating that user towards OSB and iGaming. We will shortly address marketing, cross-selling and other tools for driving traffic, but we will now begin to frame and size the market opportunity for different types of *real* gambling (OSB and iGaming).

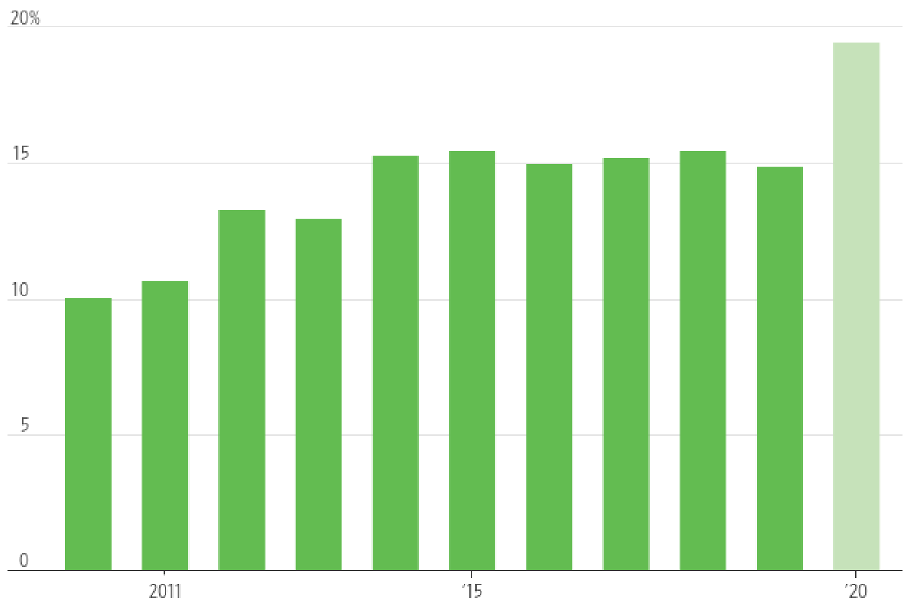
## Trading Replaces Gambling (only temporarily):

Retail investors are "in love" *again* with stocks. August 2020 was the best August in over 30 years, since 1986. We don't believe retail embracing the stock market again is just due to free trading, otherwise known as the "Robinhood" effect. While Robinhood was the first to push "free trading", it was followed by Schwab, TD Ameritrade, E*Trade, Fidelity and others in late 2019.

So what is driving retail trading? Is it more discretionary money in consumer's wallets, from less entertainment spend? Are people investing their COVID-19 stimulus checks in the stock market? Maybe retail is suffering from FOMO or "fear of missing out", as everybody chases Amazon, Apple and Tesla? Is it an absence of sports to gamble on? Maybe people are just bored at home and looking for a diversion or outlet? There's no right answer, but retail is clearly back investing in the S&P 500.

As this chart shows, individual stock trading is at a decade high. During the 2nd quarter of 2020, trading volumes at Interactive Brokers, Schwab, TD Ameritrade and E*Trade were up +111%, 126%, 312% and 267% year-over-year. Last month, TD Ameritrade and E*Trade were up 369% and 288% respectively. We shouldn't feel bad for the online brokers, who all went free last year, as they are still able to monetize this volume. Not only do they make great economics on options trades, but still earn solid PFOF (payment for order flow), as detailed in Rule 606 reports.

Individual investors' estimated share of U.S. equities trading volume




Note: 2020 data are for January through June.
Source: Bloomberg Intelligence

According to Bloomberg Intelligence, during the first half of 2020, retail investors accounted for roughly 1/5th of total US stock trading. This is over 30% higher than last year and more than double that from 2010. Citadel Securities, which is a dominant electronic trading firm, believes that retail trading is approaching 25% of total market volumes. Without a doubt, one of the most popular and funny Twitter follows is Barstool's Dave Portnoy. Portnoy leads an army of day traders under the moniker of DDTG or Davey Day Trader Global. In June, Portnoy said the stock market's volatility is "kind of like watching a sports game." We fully expect sports gambling to bounce back, now that sports have started up again.

The PGA and golf was first major sport to re-start its season, in May. While some may not consider golf to be a major sport, we at Manole Capital are huge fans. The NBA and basketball re-started in July and will crown a new champion in October. The NHL and hockey also started playing games in July, with a Stanley Cup champion expected over the next one to two months (let's go Tampa Bay Lightning). The NFL and football are preparing for their season to start in early September with a Super Bowl champion on February 7th, 2021. As we discussed earlier, the NFL or National Football League is the most profitable and successful of the major sports leagues. In addition to simply watching football each Sunday at 1pm, it has branched out to Thursday, Sunday and Monday night games. In addition, the NFL has launched its own channel, which continues to garner impressive TV ratings. While professional football is the most profitable of the major sports, there was an enormous opportunity to leverage fantasy leagues into other sports.

Only time will tell if the plans and details these leagues are creating will work. COVID-19 is still a very fluid situation and whether or not sports can occur next month or next quarter is still a question mark. Leagues have limited the on-site viewing and attendance, while trying to create a "bubble" environment to protect their players and limit the ability of the virus to spread. We hate to use cliché's, but this clearly is unchartered territory. Now that sports have re-started, we will now begin to layout the overall market opportunity and size.

## The Total Addressable Market or TAM for Gaming:

According to DKNG company reports and Eidlers & Krejcik Gaming sources, the global gaming market, stated in GGR (gross gaming revenue), was estimated at $456 billion in 2019. As this pie charts shows, 35% was Casino related, 20% was gaming machines and slots, 26% was lotteries, 3% was Bingo and 16% was derived from sports betting.


We will attempt to breakout machines/slots and sports betting into further detail to frame the opportunity for DKNG and other platform providers.


In our opinion, it's important to separate DFS (daily fantasy sports) wagering from sports wagering (i.e. will Team X cover the spread against Team Y) from casino games.

We will separate casino games (slots and table games) and identify them as iGaming. We have briefly discussed DFS (daily fantasy sports), but it is considered the smallest of these potential opportunities. Let's start with the OSB (online sportsbook) category and break it down into various components.

## OSB:

Sportsbooks are physical locations where people can wager on various sports. Instead of restricting gambling to those that visit and wager at these dedicated locations, mobile phones and online access has dramatically increased the available opportunity.

So, sports betting is 16% of this total addressable market of $456 billion or annual GGR of $73 billion. This includes horse racing, but we feel it significantly underestimates the massive global market opportunity.

Each year, sports betting is conservatively estimated to be a $175 billion industry. Football remains the most popular sport to bet on in the US, estimated to eclipse $100 billion each year. The NBA, MLB and NHL are estimated to do another $75 billion each year. These numbers do not reflect the massive college basketball (March Madness) and football (Playoffs) markets.

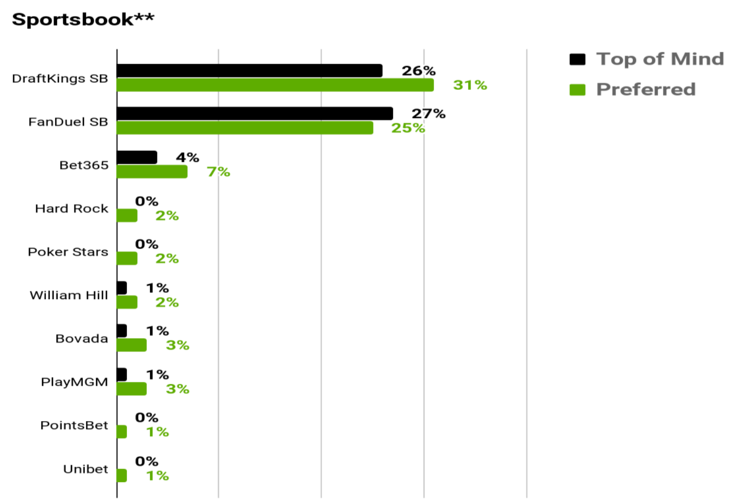
The Nevada Gaming Control Board (NGCB) and other similar state agencies report the total amounts sportsbooks "handle." In Nevada, in 2019, the NGCB stated $5.32 billion worth of sports bets were made. New Jersey, in its first full year of legalized sports gambling handled $4.58 billion. While the amounts reported by regulatory agencies are certainly impressive, their numbers only capture a small slice of the actual market. The black market for gambling, as well as the offshore sportsbooks easily could be 10x these legal amounts.

With so many leagues temporarily suspended due to COVID-19, sports betting revenues in March, April and May noticeably fell. Revenue projections at many sportsbooks were down 90% for April and 70% for May. Although most leagues have returned, COVID-19 capacity restrictions will most likely remain a headwind for physical sportsbooks locations. We believe the greatest opportunity for sportsbooks is to embrace technology and migrate online, from physical or brick & mortar locations. Despite no major sports getting played in the 2nd quarter, DKNG was still able to generate $75m of revenue. We believe there is pent-up customer demand to gamble, considering the 1st half of 2020 for live sports was essentially postponed / delayed.

OSB is a large opportunity for DKNG, as Americans love to bet on sports. At DKNG's March 2020 analyst day, it attempted to highlight the total US market for sports betting. We personally don't love DKNG's estimates, as it potentially overestimates the overall market. DKNG arrives at its opportunity by extrapolating New Jersey's current results (as a percentage of the US population) across the entire US population. While mathematically this makes sense, we do not believe that New Jersey is necessarily indicative of how the rest of the US intends to gamble (if at all). DKNG uses the New Jersey example to arrive at a US sports betting estimate of $18 billion. For perspective, the sell-side analysts that currently cover DKNG also estimate the addressable US market at $18 billion per year. When we discuss our model and estimated financials, we will try to be more conservative; we will use a total US market roughly 2/3rd's of this estimate or ~ $12 billion.

Using this top down approach, DKNG attempts to arrive at a revenue estimate (derived from OSB) over the next few years. That $21 billion estimate for the total US addressable market assumes that 65% of the US population would have access to a legalized OSB. Then, DKNG estimates that it can capture 20% to 30% of the overall OSB market. This would result in $2.3 billion to $3.5 billion in gross OSB revenue.

As this charts shows, there is plenty of competition in the OSB market. DKNG believes that is has both the leading "top of mind" presence, as well as preferred platform to gamble on sports. If they could have acquired FanDuel in 2016, it would have controlled in excess of half of an early and emerging market. Can DKNG keep its roughly 25% share of the overall OSB market? Are peers providing a better proposition, that would allow them to garner additional market share? These are some of the bigger picture questions that we will attempt to discuss and address over the next few pages.




## iGaming:

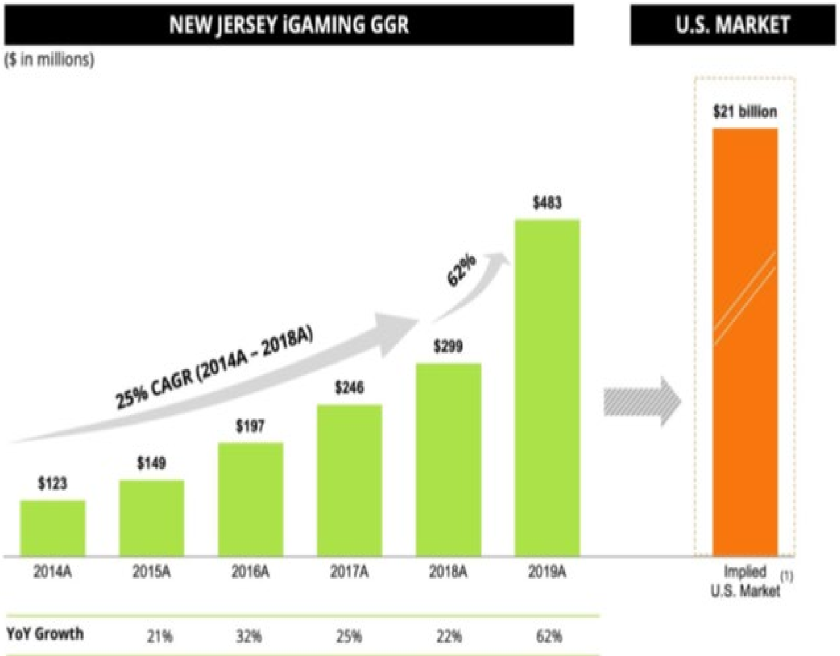
As we just stated on page 3, the largest component of this $456 billion GGR pie is attributed to casinos (at 35%). Casinos have a GGR of nearly $160 billion and we should probably add slots and gaming machines to that total too. Gaming machines and slots are 20% of the global market or over $91 billion. Combining these two segments, annual GGR is over $250 billion. This is a massive opportunity for platforms to once again capture market share (from physical locations), as gamblers migrate online.

Five years ago, New Jersey made iGaming legal and it remains the largest iGaming state, in terms of GGR. According to the New Jersey Division of Gaming Enforcement, New Jersey in 2019 did an impressive $483 million of GGR. This was up an impressive 62% year-over-year. Over the last 5 years, the GGR in New Jersey has shown year-over-year growth of 21%, 32%, 25%, 22% and 51%. It really is rare to see the growth rates continue to rise, as the GGR levels reach higher and higher levels. As DKNG likes to do, if you extrapolate New Jersey's GGR (as a percentage of its population to the whole US), the estimated market opportunity could be $21 billion. Even if it is only ½ of that level, the iGaming opportunity is clearly quite sizeable.

Looking at the 4$^{th}$ quarter of 2019 statistics, one can see there are plenty of competitors looking to capture this market. For example, Betfair / Flutter had 17% market share. That was followed by DKNG at 15%, Golden Nugget at 13%, Borgata at 9%, Sugarhouse at 8%, Tropicana at 7%, Resorts at 6%, Caesars at 5%, Hard Rock at 4% and Other at 15%.

iGaming is a large opportunity and DKNG has unveiled a standalone casino application (i.e. an app) to attract new players. On the Apple App Store, it has a positive 4.8 stars, out of 5. This app has over 310 slot games, 15 live dealer games, and 35 table games ranging from blackjack to roulette. This is currently live in NJ, PA and WV and we imagine it will look to expand into other states shortly.

By launching iGaming inside of DKNG's OSB, it has been able to meaningfully cross-sell its customer base. For example, 46% of New Jersey's DKNG sportsbook users have already placed a casino bet with DKNG (through March 2020).




Once again, at DKNG's analyst day, it attempted to frame its iGaming revenue opportunity over the next few years. If one assumes that iGaming will be legal in states representing 30% of the US population, DKNG believes the total US market is $21 billion.

Then, it DKNG believes it can capture 10% to 20% of that iGaming market. This would result in $600 million to $1.2 billion in gross iGaming revenue.

Now that we have framed the total addressable market and separated DFS from iGaming from OSB, now let's do a deeper dive on DKNG's specific business.

## Competition:

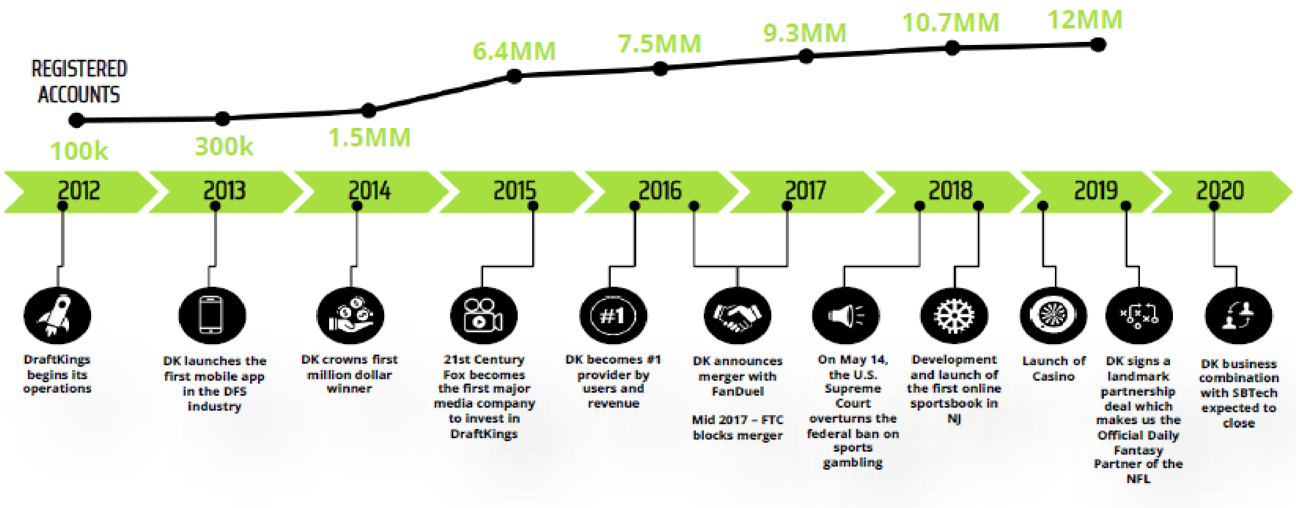
In terms of fantasy sports, Yahoo has a significant presence, as does ESPN. Then, one has to consider the brick & mortar casinos / hotels, that are looking to capture a share of this growing business. As we mentioned earlier, in New Jersey alone, there are a dozen casinos very interested in growing their iGaming revenue (Golden Nugget, Borgata, Tropicana, Caesars, Hard Rock, etc). These entities have strong relationships with regulators, leagues and the media, so their impact will be meaningful.

If one just looks at New Jersey, which launched in August of 2018, there are over 15 operators in that state. Fanduel Flutter has 43% market share, followed by DKNG at 31%. West Virginia launched a year later, in August of 2019, and it only has 2 operators. DKNG has 65% market share, followed by Fanduel Flutter at 35%. Oregon and Indiana launched in October of 2019 and both states are dominated by DKNG.

In our opinion, we think DKNG has an enormous opportunity, but significant competition. There are numerous other players worth mentioning and we will highlight these companies in our "Issues & Concerns" section.

## Who Is Draft Kings?

Draft Kings was founded in 2011 by Jason Robins, Matt Kalish, and Paul Liberman. All three remain involved in DKNG today, with Robins acting as CEO, Kalish as President of North America and Liberman as President of Global Technology and Product. In 2013, the company launched its first mobile application, quickly capturing a massive share in the online market. DKNG has even received significant investments from major reputable companies such as 21st Century Fox's investment in 2015 and Disney's 18.2 million share position (for a total of 6% of the total shares outstanding).




In 2014, New Jersey passed a law allowing sports betting to occur at its in-state casinos and racetracks. New Jersey wanted to assist struggling Atlantic City and offer sports betting to those within the state. Following this, there was a legal battle between New Jersey and several major professional sports leagues, captured in the case of Murphy vs the NCAA. Before we address this lawsuit, we think it would be helpful to go back in time and discuss PASPA (also known as the Bradley Act).

## What Is A PASPA?

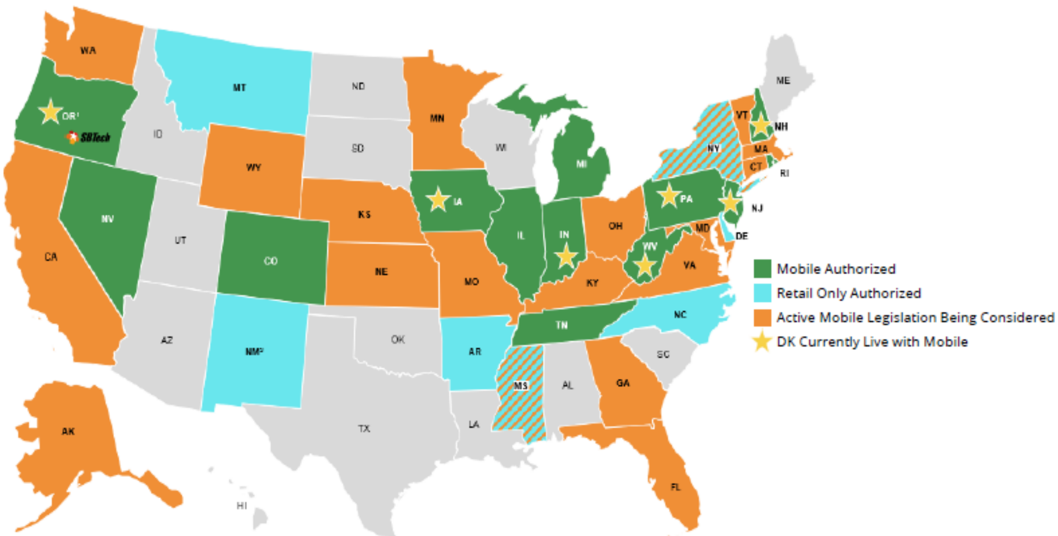
Bill Bradley played in the NBA for 13 years and then went on to serve as one of New Jersey's Senators from 1979 to 1997. Bill Bradley introduced the Professional and Amateur Sports Protection Act (PASPA), also known as the Bradley Act in February 1991.

The Bradley Act essentially prohibited gambling on sporting events. PASPA was signed into law by President Bush in 1992 and it outlawed states from offering any type of legal sports betting. We find it quite ironic that Bill Bradley served as New Jersey's US Senator for 3 terms, but it was his state that legally challenged PAPSA.

On May 14th, 2018, the US Supreme Court struck down PASPA as unconstitutional. By overturning PASPA, betting on live sports became legal. In August of 2018, DKNG has launched both casino gaming, as well as sports betting in New Jersey. We do <u>not</u> want to dive too deep into the legal complexities, but we will try to summarize the current environment.

Every state has their own financial burdens, but COVID-19 has certainly negatively impacted city and state budgets. With certain state budgets in ruins, many are actively looking for additional tax revenues. States are desperate to offset the ballooning costs of unemployment, as well as healthcare and social services costs. Some have legalized marijuana, while others are beginning to look at sports gambling and casino revenue.

As this chart shows, certain states have passed legislation specifically allowing sports betting. Others are permitting it, but only on-premise, at one of their approved physical sportsbooks. Other states have authorized sports betting via one's mobile phone. It really is a hodgepodge of state laws and regulations.




States seem to be embracing sports betting slowly and in stages. We have no idea when sports gambling will be legal and available across all 50 states, but the potential is large, even with only half of the states committed today. We have to imagine that further budget problems will eventually bring 30 and then 40 states onboard.

| | State | % of U.S. Population |
|---|---|---|
| 1 | New Jersey | 2.7% |
| 2 | West Virginia | 0.6% |
| 3 | Indiana | 2.0% |
| 4 | Oregon | 1.3% |
| 5 | Pennsylvania | 3.9% |
| 6 | New Hampshire | 0.4% |
| 7 | Iowa(4) | 1.0% |
| 8 | Nevada | 0.9% |
| 9 | Rhode Island | 0.3% |
| 10 | Tennessee(5) | 2.1% |
| 11 | Washington, DC | 0.2% |
| 12 | Illinois | 3.9% |
| 13 | Colorado | 1.7% |
| 14 | Michigan | 3.1% |
| 15 | Delaware | 0.3% |
| 16 | Mississippi | 0.9% |
| 17 | New Mexico(6) | 0.6% |
| 18 | Montana | 0.3% |
| 19 | Arkansas | 0.9% |
| 20 | New York | 6.0% |
| 21 | North Carolina | 3.2% |
| | **% of U.S. Population** | |

New Jersey, the first to launch since PAPSA was overturned, was able to generate nearly $300 million of gaming revenue in 2019. Nevada already had legal sports gaming and recorded slightly higher revenues in 2019 at $329 million. Pennsylvania, the 3rd largest market (in terms of launched population size), reported $124 million of gambling revenues via mobile wagering after launching in August of 2019.

As this chart shows, following PASPA's repeal in May 2018, 21 states representing 36% of the US population have ***legalized*** sports betting (in some form of retail, mobile or both). Of these 21 states, 14 have ***online*** sports betting, representing 24% of the US population. DKNG is now live in 8 of these states, representing 14% of the US population. DKNG is currently operating in New Jersey, West Virginia, Indiana, Oregon, Pennsylvania, New Hampshire, Iowa and now Colorado.

Speaking of Colorado, DKNG became 1 of 4 mobile operators to enter the state on May 1st. How did its launch compare to other states DKNG launched in? Well, Indiana is 2.05% of the US population and that state generated $3.0m of GGR in May and June of 2020. Pennsylvania is 3.90% of the US population and it generated $3.6m of GGR, over the same period. Colorado is smaller than both of those states, at only 1.75% of the US population, but it did $3.5m of GGR in its 1st two months. This latest state launch seems promising. The next 3 states where DKNG plans to launch are Tennessee, Washington DC and Michigan.

Multiple states having authorized or passed legislation to permit sports betting, but have not yet implemented or launched that capability. There are another 15 to 20 states where mobile gaming legislation is being considered.

Regulatory compliance is important and DKNG needs to follow strict KYC rules. Using GEOComply and their plugin technology, DKNG can detect the exact location of every log-in, bet placed and transaction attempt.

We believe, with state budgets in disarray, the addressable market for mobile sports gambling in the US could increase tenfold, over the next decade. With travel being restricted or considered less desirable, the opportunity for iGaming and sports gambling (via one's mobile phone), has never been greater.

## How Did DKNG Go Public?

On May 10th, 2019, Diamond Eagle Acquisition Corporation or DEAC led by Jeff Sagansky and Harry Sloan became a publicly listed special purpose acquisition vehicle or SPAC. Raising $400 million, the SPAC traded under the symbol DEACU and was the 5th SPAC vehicle that Jeff Sagansky and Harry Sloan launched. On December 23rd, 2019, DEAC announced that it was acquiring DKNG. On April 23rd, 2020, DEAC officially purchased DKNG and the combined company began to publicly trade on Friday April 24th.

From December of 2019 to now, the DKNG stock has been on an impressive climb higher. The values of the combined businesses were $2.7 billion, based upon DEAC's initial book value. At the time of the acquisition, DKNG founders and shareholders rolled 100% of their equity ownership, while SBTech shareholders put in $450 million of equity. With the deal, DKNG and DEAC raised another $372 million in PIPE equity from various investors.


Following the deal, DKNG had a dual class shareholder structure, with super voting rights in Class A (1:1 voting) and Class B shares having 10 votes per share. CEO Robins owns both share classes, but holds roughly 90% voting power of the company. Initial shareholders now own 75% of DKNG, the SPAC or DEAC shareholders own 13% and these new PIPE investors own 13%. After all the dust settled, DKNG was a public company. It has 2,100 employees in 12 worldwide offices and 22 licenses to handle gambling in 26 various countries.

## Mission & Vision:

When DEAC combined with DKNG, it stated that DKNG was a "digital sports entertainment and gaming company, known for its industry-leading daily fantasy sports and mobile sports betting platforms".

The ***mission*** of DKNG is "to make life more exciting by responsibly creating the world's favorite real-money games and betting experiences". In addition, DKNG's ***vision*** is to "build the best, most trusted, and most customer-centric destination for skin-in-the-game fans, to develop the most innovative and entertaining real money gaming products and offers, and to forever transform the manner in which people experience sports". We copied that directly from their language, as we think it could be the world's longest run-on sentence.

## Metrics & Users:

DKNG provides some key performance indicators to investors. It is one thing to look at their stated +12 million registered accounts, but it is more interesting and important to follow those users that are actively on the platform. We plan on following two metrics quite closely.

One is ***MUP's*** or monthly unique payers. These are those paid users that had a paid engagement in a DFS contest, sports bet or casino game. Looking at 2017 to 2018, MUP's grew from 574,000 to 601,000 or 4.7%. In the 2nd quarter of 2020, MUP's were at 295,000, down 35%, from 456,000 a year ago. Without live sports, this metric clearly weakened.

The other key metric is ***ARPMUP*** or average revenue per MUP. Say that 3x, right? In 2018, the average revenue per MUP grew 10.7%, from $28 to $31. However, in their most recent quarter, ARPMUP was up to $63 or an increase of 50% versus last year. In our opinion, this is a key metric to follow, as it shows how DKNG is really beginning to monetize its customer base. As DKNG tries to turn users into profitable customers, their investor presentations seem to focus more attention and emphasis on cross selling techniques.

## Cross-Selling and Marketing:

DKNG believes it has a three pronged approach to driving its business. The three core verticals are DFS or daily fantasy sports, its OSB or online sportsbook and iGaming. Using its proprietary data science and analytics, DKNG believes it can market to its millions of players across these three channels.


Their cross-selling opportunity looks a little something like this: start with a few million fantasy sports users and promote, with a roughly 30% cross selling rate, to their sportsbook. The DKNG sportsbook is then leveraged to bring gamblers into DKNG's casino. Through this process DKNG claims a 50% cross selling rate from the sportsbook to the casino.

In its opinion, DKNG has a vertically integrated technology platform to capture players across each of these products. The question becomes if gamblers prefer to separate their iGaming to a traditional casino, their sports betting to their local bookie and their daily fantasy sports to Fanduel or others. This would spoil DKNG's concept of capturing its players across all three channels. DKNG believes it has a sustainable differentiation versus its peers.

When (not if) the NFL season starts next month, we anticipate DKNG will do remarkably well. We believe that a key strength of DKNG is the ability to cross sell various products across its platform to its loyal customers. Last year, DKNG signed up to be the official daily fantasy partner of the NFL. We believe this will generate positive business for DKNG next month. However, DKNG is diving deeper than just TV ads. It is looking to gather user data and drive user-engagement via one's smartphone. Since everybody has their cell phone permanently in their hand, this might be a great tool to drive customers and users. If DKNG knows that we are watching a Sunday football game, it could push out the ability to bet on the next quarter or even the next play. It has the technology to allow users to bet on whether or not field goals with be good or missed. It can let gamblers bet on who is the next person to score a TD or even catch a pass. The ability to parse data and reach gamblers on their phone is intriguing. We worry that it could be contagious or even addictive to certain people, but that's a subject for another time and note.

While there is only a modest number (under 100k) of DKNG users that utilize all three of their verticals, it clearly understands the power having several touchpoints to its customers wallets. This process and focus on cross-selling reminds us of the successful data and information program underneath Harrah's Entertainment. That loyalty program (called "Total Rewards") was often considered the "crown jewel" of Harrah's; many gaming insiders credit "Total Rewards" as the main reason Harrah's was able to generate industry leading traffic metrics.

Marketing automation can help DKNG reach its potential and existing users, but it is not a cure all . Using data and its analytical models, DKNG spends money to target customers on direct mail, social, outdoor, videos, podcasts, radio, TV and search. It believes that it can maximize ROI (return on investment) across all of these paid media channels, but we are less convinced of this. DKNG can say that it has sophisticated data science driving its marketing decisions, but a costly TV ad is usually not a wonderful ROI proposition (in our opinion). Just like that Schwab or TD Ameritrade, Fidelity or E*Trade ad on CNBC doesn't spur us to open an account, we are less than convinced that a DKNG ad during a Sunday football game with motivate us to gamble.

In this stay-at-home environment, DKNG feels it can get a positive response to its TV and radio advertising spend. Frankly, one cannot watch a NBA or NHL playoff game without being inundated with DKNG ads. It believes it is the most trusted brand, with its 8 year head start versus others in DFS. DKNG feels that its "marketing machine" is poised to deliver across multiple platforms and that it has geographic flexibility (across multiple states and countries), to scale this regulated industry.

| Costs: | 2q'20 | YoY | % of Revenue |
|---|---|---|---|
| Sales & Mktg | ($47) | 49% | 63% |

## Technology:

In 2019, DKNG acquired SB Tech for $3.3 billion in a reverse merger. SBTech was an online gaming technology leader and it has a decade of experience in over 20 regulated markets and jurisdictions. SBTech gives DKNG a strong omni-channel solution and greatly improves their technology capabilities. Looking at SBTech's 2019 geographic revenue mix, 54% was from Asia, 42% was European and UK based and 5% came from the US. Clearly, SBTech added an international component to DKNG's business.

SBTech provides DKNG the technology to move across various channels, from fantasy to iGaming to lotteries to the sportsbook. Quite simply, SBTech is the “plug and play” option for certain global channels.

However, the key (in our opinion) is DKNG’s wallet technology. One seamless wallet, across all products, can be a game changer (no pun intended). We believe that players will become loyal to a certain brand, if the onboarding process is fairly easy. Having a low-friction experience is important and DKNG has solved this problem with simplified verification and an easy KYC (know your customer) process. Next, ensuring that players can save their preferred payment methodologies is important. Do players want to provide DDA (demand deposit account) information to debit their banking accounts? Would players prefer the ability to load up a wallet from a credit card? DKNG is PCI (payment card industry) level one certified, so users feel comfortable that their payments are secure. One of the key differentiators for us is DKNG’s wallet technology. As users move from state to state, from product to product, DKNG has the capability to create compliant sub-wallets in the background. By using virtual wallets, DKNG provides a seamless experience for its players, without them ever knowing what is happening on the backend.

We believe that DKNG had solid technology and an easy-to-use platform in DFS. The iGaming platform was also a DKNG capability. However, SBTech seemed to be the necessary ingredient to give DKNG the sports betting platform it needed. From what we have been able to garner, SBTech came with 3rd-party risk and trading capabilities that DKNG simply didn’t have. SBTech’s sports betting platform was simply much better than core DKNG possessed. The analogy that DKNG likes to use is that it had the core body of an OSB, but SBTech provided the engine. Specific examples of SBTech’s technology are complex risk management, intelligent bet acceptance, enhanced odds based upon real-time tools, innovative 3rd party integrations, etc.

## Issues & Concerns:

As we have stated multiple times, this is a very competitive industry and business. There are no shortage of players that are interested in the OSB and iGaming market. In our opinion, Fanduel and Barstool represent DKNG’s two largest competitors.

Fanduel, with a majority owned by FLTR, has nearly 10 million customers, including a half a million horse racing players. It has an estimated 40% of the US DFS market and a very strong international presence. Both Fanduel and DKNG are coming to market with an asset light model, without traditional hotels and casinos. PENN is attacking the market from a different perspective, as it already has a large physical presence.

PENN, the owner of Barstool, is slated to launch their betting app in September (initially in Pennsylvania, as this picture shows). PENN will capture market share in this important state and build off of Barstool’s 100 million followers. That’s right! The two guys (David Portnoy and Big Cat) have a tremendous following and we expect this launch to be quite successful. Once again, if you want to follow one of the funniest Twitter handles out there, we absolutely recommend following David Portnoy (for his pizza recommendations, as well as for stock commentary).

Of their social followers, the demographic is remarkably attractive. For example, 83% of Barstool’s audience is between the ages of 21 and 54. Barstool has released additional insights into how they plan on attacking the OSB marketplace. Barstool surveys have stated that 62% of its followers have bet on sports and of those bettors, 44% bet 1x per week at an average amount over $51 per bet. As PENN blitzes the market with advertisements, we would anticipate a market share decline for DKNG, possibly from the mid-30%, down to 20% or 25%.

Bet365 is another key competitor and it has a sizeable balance sheet at its disposable. It has 45 million registered customers in over 150 countries, but its best attribute might be its technology. Bet365 has the capability to enable "in game" betting. As we talked about earlier, this can be thought of as being able to bet whether or not Tiger Woods is able to make that birdie putt on the 18th hole of The Masters. We think this will be an enticing proposition for many gamblers to wager on. There are additional peers to worry about too, like Fox Bet (with Fox Sports), MGM (with Yahoo Sports and Buffalo Wild Wings) and William Hill (with Caesars and CBS Sports). Quite simply, there are a dozen real companies all trying to capture a slice of this large addressable marketplace.

With the re-start of sports, DKNG has seen a nice uptick in business. For example, DKNG mentioned that it experienced a 300% lift in amount wagered on baseball, when the MLB returned. As we discussed earlier, we believe that football is the dominant US sport for gamblers. As of today, NFL football is slated to begin on September 10th, when the Houston Texans hot the Super Bowl champion Kansas City Chiefs. College football's Big Ten and Pac-12 conferences have already cancelled games in 2020, but the SEC, Big 12 and ACC are planning on fall football. As school's open up, COVID-19 remains a big unknown and challenge. If football gets cancelled due to COVID-19, this would have an adverse impact on DKNG's DFS and OSB businesses.

Just a couple of weeks ago, the IRS issued a memo, indicating a plan to place a 0.25% excise tax on DFS contests. This is not a tax to the players, but rather a tax placed on the gaming operators (i.e. DKNG or FanDuel, etc). Also, it is not applicable to traditional season-long fantasy competitions, just daily contests. Apparently, the IRS wants to treat daily fantasy contests just like traditional sports bets or wagers. On their conference call, DKNG indicated that daily fantasy games were $3.2 billion in 2018, which would equate to a $8 million tax. 2019 was a higher amount of daily fantasy games, so the potential tax could be in the $10 million range. DKNG management called the IRS memo "deeply flawed in its analysis", but it is not a positive impact for free cash flow. This IRS issue is still an open item, but DKNG fell by 7% when this was announced. Overall, this excise tax is not a major concern; maybe just an ongoing issue to monitor and factor in.

Another concern for us, over the next quarter or two, is how DKNG will trade. Over the next two to three months, a considerable number of shares will become available for sale. Out of DKNG's +350 million shares outstanding, only 40% freely trade today. One could argue that increasing the tradeable float is a good thing, especially if these shares head to long-term owners and investors. On the flip side, when lock-up's typically expire, DKNG could see a material oversupply of stock and selling. Many early investors have seen a huge paper windfall and may look to monetize some or all of their holdings.

Lastly, one item that concerns us is the ability of DKNG to scale its business and generate scale economics. As the line items below show, DKNG is aggressively spending. In the 2nd quarter, we understand that revenues were soft, due to COVID-19 and the delay of sporting events. However, only $75 million in revenue is not sufficient to support a model with these types of costs. We already discussed sales and marketing, which DKNG needs to drive traffic and maintain its market share. Does G&A doubling year-over-year make sense? Maybe, if management feels like it needs the infrastructure larger to support the business. Maybe that is bloated, due to the SBTech acquisition? In terms of technology spend, we are comfortable with that increase, as this the equivalent of R&D spend for a biotech or pharma company. Without technology spending, DKNG cannot reach its market share goals. One last item, that concerns us, is the stock compensation. We understand that all companies grant employees stock compensation, in addition to a normal salary. That's not our problem. We do question stock compensation running at 87% of revenue and that eye-popping year-over-year increase. We feel the board and management need to reign in some of those grants and consider the impact it has on existing and future shareholders.

| **Costs:** | **2q'20** | **YoY** | **% of Revenue** |
|---|---|---|---|
| General & Admin | ($91) | 205% | 122% |
| Technology | ($36) | 70% | 49% |
| Stock Comp | ($65) | 3138% | 87% |

## Revenue:

A few pages ago, we attempted to focus on the total US addressable market for iGaming and OSB. Estimates and forecasts must be taken with a "grain of salt", especially at such an early stage of growth. Using company estimates can be aggressive, since they are clearly laying out the case for huge upside. Sell-side analysts often take company management forecasts and weave them into their models to arrive at a price target to match their rating. We do not have to worry about publishing formal estimates and will simply choose to be a little more conservative in our projections. We will not model this business out further than 2025, as anything more than four to five years out is simply unknown and guessing.

In terms of 2025 revenue, coming from US OSB and iGaming, we think it could approach $12 billion. If the US market approaches $3 billion in annual revenue this year, this would imply a 35% CAGR (compound annual growth rate) for the next few years. Is that possible? Yes, but it isn't a terribly conservative estimate of future growth. A lot would need to occur, for the industry to grow at those levels. In our opinion, this is a roughly broken down 70% versus 30%, in terms of OSB versus iGaming. That would equate to $3.5 billion of iGaming and $8.5 billion of OSB.

We always try to begin our analysis by looking at organic growth, for this will tell us how much a company can grow on its own. While most companies can acquire growth, especially with interest rates at near zero, we find that organic growth is an important metric to always consider.

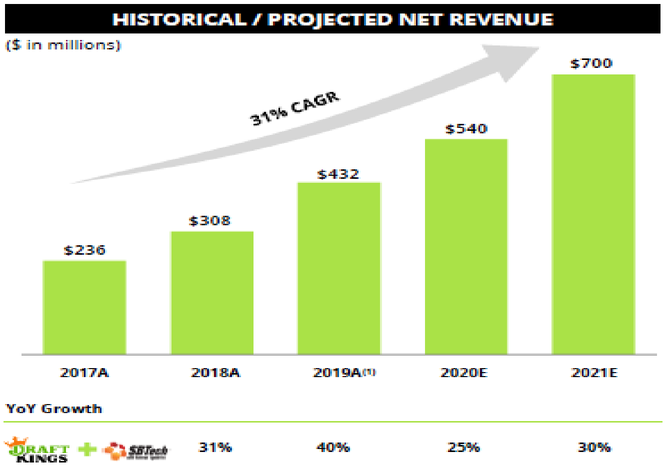
| | **2017** | **2018** | **2019** |
|---|---|---|---|
| **DraftKings** | $192 | $226 | $305 |
| *growth* | | 18% | 35% |

As this shows, DKNG has been able to organically grow handsomely. Then, following its acquisition of SBTech, DKNG was able to layer on a solidly growing business.

| | **2017** | **2018** | **2019** |
|---|---|---|---|
| **SBTech** | $44 | $82 | $110 |
| *growth* | | 86% | 34% |

Looking at the combined company, we can see that DKNG is generating well over $400 million in sales a year. Looking at analyst projections for next year, we would expect $540 million in revenue or 37% year-over-year growth. Looking out to 2021 and 2022, analysts project $700 million and $1.25 billion

| | 2017 | 2018 | 2019 |
|---|---|---|---|
| **Total** | $236 | $308 | $432 |
| *growth* | | 31% | 40% |




Revenue in 2017, 2018, 2019 was $236 million, $308 million and then $432 million, showing impressive +30% annual growth. DKNG management is guiding and projecting revenue to grow 25% this year to $540 million and then 30% in 2021 to $700 million. 2020 assumes the OSB is live across 10% of the US population, with iGaming in NY and PA. This does not seem terribly difficult, in our opinion. The 2021 assumptions are OSB across 20% of the US population, with iGaming getting legalized in additional states (representing 4% more of the US population). Once again, we believe this is very achievable, as far as revenue or the top line is concerned.

There is seasonality to factor in, as the 4th quarter is typically the best quarter, with the 2nd and 3rd quarter being the two softest. If DKNG can generate $700 million in 2021 revenue, this would equate to 17% of our 2021 US addressable market revenue opportunity of over $4 billion. If one combined the OSB and iGaming opportunity of roughly $40 billion in TAM, DKNG believes it can lead to gross revenue in the $2.9 billion to $4.7 billion range. Once again, we think the total addressable market is somewhat smaller than DKNG has estimated, but $4 billion is pretty much in the middle of their guided range. The bigger question is whether or not we believe DKNG can maintain a high-teens to 25% market share? We do…

We believe that DKNG can garner 15% to 25% of the OSB and iGaming market. We do not want to forecast out 10 years into the future, so we will only go out to 2025. If we work with our $12 billion US revenue opportunity and believe that the industry can post significant growth (over 30%), we can back into a DKNG revenue estimate, with a few different market share assumptions. At 15% market share, DKNG would have 2025 revenue of $1.8 billion. At 20% and 25% market share, DKNG would generate $2.4 billion to $3 billion. For our purposes and to arrive at an EBITDA level, we will use $2 billion of revenue for DKNG in 2025.

Now that we have a 4 year forward estimate for revenue, we need to begin to understand if DKNG is able to generate any profits or free cash flow. Can DKNG generate decent operating margins on that level of revenue? Are the investments that DKNG making today wise? Can the company scale operations to drive profitability once revenue begins to come flowing in?

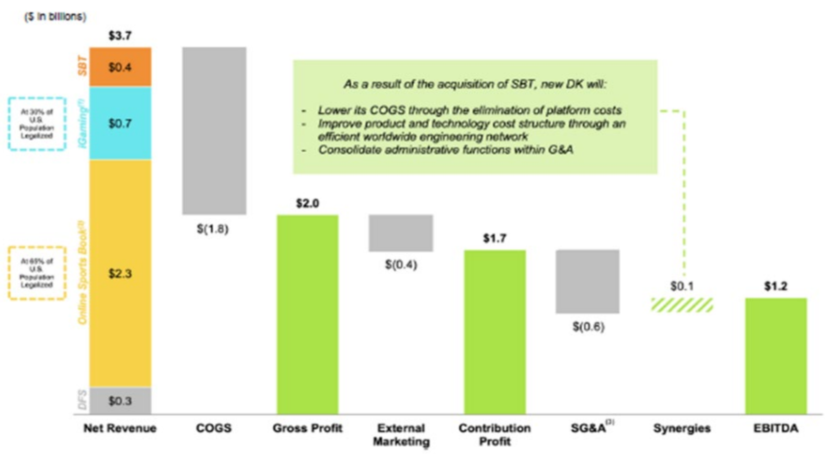
## EBITDA:

| EBITDA | 2q'20 | YoY | % of Total |
|---|---|---|---|
| Proforma & Adjusted (b) | ($60) | 283% | n/a |

As these details show, DKNG is not able to generate positive EBITDA right now. DKNG is a stock that requires us to look into the future and project what margins could theoretically become.

As we have stated previously, DKNG likes to use New Jersey as its test case and then it likes to extrapolate that experience across the entire country. It found that after the initial launch year, states generated a negative gross profit margin. Then, after one year, DKNG believes that gross profit margins can be in the 25% range. By year two and three post launch, gross profit margin rises to 29% and 37% respectively.

These estimates and forecasts entirely depend on DKNG's ability to generate positive operating leverage and realizing significant operating scale efficiencies. Sticking with this New Jersey example, DKNG believes it can achieve a 38% contribution margin in year 5, as well as a 50% gross margin. We prefer to be conservative and will likely use a lower estimates for our model. Once again, taking New Jersey as the example and carrying it across the US population, DKNG has laid out a plan to be at $1 billion in adjusted EBITDA.




How is this arrived? Well, it goes back to our earlier discussion framing the revenue opportunity. As seen in this DKNG slide, the potential revenue estimate and opportunity is $3.7 billion (in some un-determined out year). This opportunity is comprised of $0.3 of DFS (8% of total), $2.3 billion of OSB (62% of total), $0.7 of iGaming (19% of total) and SBTech of $0.4 (11% of total).

The OSB depends on an aggressive 2/3rd's of the US population being able to bet, as well as 30% of the US population being able to iGame. If one assumes a gross profit of roughly 50%, that would be $2 billion. Then, there's $400 million of marketing to account for, bringing contribution margin down to $1.6 billion. With another $600 million of S,G& A, would result in roughly $1 billion of EBITDA.

We do not believe that DKNG can hit $1 billion of EBITDA in the next four to five years. However, we can get close to that, if we assume 35% EBITDA margins by 2025. Using our $2 billion in revenue and applying a reasonable 35% EBITDA margin, we arrive at $700 million. Now we built a guestimate for 2025 revenue and EBITDA. Let's now attempt to calculate a price target and valuation.

## Valuation:

DKNG has a stock price of $36.50 per share and outstanding shares of 350 million. This equates to a market capitalization of $13 billion. With no debt and cash of $1.2 billion on its balance sheet, DKNG has an enterprise value of $11.8 billion

No analysts expect DKNG to generate earnings over the next 2 to 3 years, so one cannot arrive at a reasonable or usable P/E valuation. Most sell-side analysts are using valuation metrics off of revenue, but this is something we loathe to do. If revenue grows towards $700 million next year and over $1 billion by 2022, we believe that DKNG management would be thrilled. Companies might be able to generate sales, but an inability to generate profitable sales is more important. The sell-side community is arriving at price to sales metrics all over the map, but we simply do not find any value in this analysis. For example, one analyst launched with a "buy" rating based upon a forward revenue multiple of 28x. The difference in its revenue multiple, from 10x to 30x would likely be the equivalent of saying the stock is worth $5 per share or $500 per share. That range is wide enough for a Mack truck to drive through it. We cannot stomach revenue multiples and will not utilize these in our valuation framework.

We could go on and on about revenue multiples, but we got some valuation confirmation from a recent launch piece from David Katz at Jefferies. He launched coverage of DKNG with a "buy" rating on June 22nd with a $55 per share price target. In Katz's mind, the DKNG opportunity was sizeable, with 50% of upside to today's price. In his upside scenario, Katz is looking for $175 per share or +379%. This would occur if regulators move faster than expected, which allows DKNG to drive growth above analyst projections. In his downside scenario, Katz thinks DKNG could be $6 per share or down 84%. This scenario is based upon delays in key states legalizing or rolling out sports betting, as well as unfavorable tax rates on mobile wagering. That's a fairly wide range of possibilities, with 85% downside compared to nearly a 4-bagger on the upside. Don't you think? The volatility of DKNG is large and it isn't a stock for the "faint of heart". Any shareholder of DKNG must be willing to accept wild swings, both up and down.

We would like to do a discounted cash flow model for DKNG, but free cash flow isn't expected to be positive until 2024 or 2025; so that too isn't helpful for valuation purposes. There are those that will look out 10 years in the future and then discount this back to today. Unfortunately, using estimates from 2030 is much more about what discount rate one uses, as opposed to being able to model out a reasonable EBITDA or earnings estimate. There is too much uncertainty and too many unknowns to build a model that calculates 2030 metrics. There are no easy valuation metrics (traditional P/E) to utilize on DKNG, but we will attempt to utilize EV (enterprise value) to EBITDA (earnings before interest, taxes, depreciation and amortization).
As we discussed above, in terms of EBITDA, DKNG is currently still meaningfully negative. However, management laid out a forecast or estimate where proforma, adjusted EBITDA could reach $1 billion in the not so distant future. We can't get to $1 billion in EBITDA by 2025, but we think it can get closer to $700 million. What's the right EV to EBITDA multiple for a company that has $2 billion in revenue, 20% market share of a growing industry and respectable 35% margins?

What comparable companies can we use to apply a fair and reasonable EV to EBITDA multiple for DKNG? Well, we wanted to start with a mix of hotel and casino operators. As we stated earlier, we feel like companies like DKNG have a superior business model to these companies, because they do not have the legacy (and costly) physical assets. The upkeep and maintenance requirement on a multi-billion property are enormous. In order to build those beautiful hotel casinos, those companies had to take off billions of dollar's worth of debt. Since we are using EV to EBITDA, these debt levels will be considered, so that's a positive. Over the last decade, these names have traded at a 8x to 12x (low to high) forward EV to EBITDA multiple. If we went above the high-end of this valuation range, considering the elevated growth of DKNG and its dominant position, we could assign a generous 14x. 14x that $700 million would equate to an EV of just shy of $10 billion. Adding back the net cash position of over $1 billion, would still not make DKNG an attractive buy. However, it does give us perspective about the sentiment and embedded thinking of the Street on DKNG. It tells us that DKNG is fairly priced, if one assumes everything we laid out and assigns a generous forward casino/hotel EV to EBITDA valuation to the business. If we are to purchase and own DKNG, we would need to get creative on its comparables.

Looking at publicly traded hotel companies might be inappropriate since so many are struggling with COVID-19 and occupancy levels right now. Looking at some of our FINTECH companies, we see some similarities to the payment networks like Visa or Mastercard or PayPal. These names trade a lofty multiples because their growth rates are impressive, their operating margins are fantastic and their free cash flow is excellent. In addition, they generate recurring revenue and each have business models that are predictable and sustainable. A name like Visa or Mastercard (over the last decade) has an average, high and low forward EV to EBITDA multiple of 21.5x, 35.0x and 13.4x respectively. Over the last 5 years, the average, high and low forward EV to EBITDA multiple has been 24.1x, 28.5x and 19.2x. We could argue to place this type of multiple on DKNG, but its business really isn't nearly as impressive as the payment networks. If DKNG is able to scale its business, over the next 5 years, it would be a "good" business, but still not truly comparable to our payment networks. For example, Visa's operating margins in the 2$^{nd}$ quarter of 2020 were in the 62%. How many companies, in the midst of a global pandemic, can generate margins in the 60% range?

If we use the same 2025 revenue and EBITDA estimates for DKNG (mentioned above), we could theoretically use a forward EV to EBITDA multiple of 20x. This would be generous and put it at a 10% to 20% discount to our payment network group 5-year and 10-year average (24.1x and 21.5x). 20x 2025's $700 million of EBITDA would equate to an EV of $14 billion. Adding in the cash, gets us to $15.2 billion or $43.50 per share (using 350 million shares outstanding). That would imply roughly 20% of upside for DKNG, over the next 4 years.

Unfortunately, this doesn't get us terribly excited. Yes, we can construct a model and valuation framework that shows upside to today's prices, but it requires a lot of assumptions and audacious estimations. We simply would prefer a better entry point and a stock price closer to $25 to $30 before we get involved. If the stock were to be impacted by any of the items we listed in the "Issues & Concerns" section, we will have DKNG on our short-list. In the meantime, we will closely monitor their results and better understand the overall industry dynamics.

## Conclusion:

DKNG has a market capitalization of $13 billion and has only recently become a publicly traded company. The volatility, in terms of stock trading, is quite high and therefore should probably not be a large position for anyone's diversified portfolio. Our concentrated FINTECH portfolio of two dozen stocks, equates to an average weight of 4%. If we got comfortable with DKNG's market share and opportunity, factoring in its high volatility, we could see us owning a small (say 2% to 2.5%) position in DKNG.

A lot still needs to fall DKNG's way, in order for it to be a good position for us. It needs to get OSB and iGaming legalized in new states across the country. Also, DKNG's will need to quickly expand into those untapped markets, fight off aggressive competition and leverage its pre-existing technology stack. If management is able to navigate these volatile conditions, DKNG stock can work.

This COVID-19 environment has devastated some businesses, but also created an interesting opportunity for others. With sports leagues starting play again, those same customers who temporarily shifted to quenching their sports cravings with Chinese ping pong, will return their devotion to the MLB, NBA, and NHL and to the NFL next month. DKNG has established a solid foothold in the ever-growing sports gambling market, which will continue to be unlocked for more and more people. To maintain and possibly grow its market share and brand awareness, DKNG will need to spend a considerable amount of money on advertising. We will watch DKNG closely, see how they manage their many regulatory hurdles and wait for better clarity in free cash flow.

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