

May 14, 2020 05:23 AM GMT

## DraftKings Inc | North America

## 1Q20: What To Focus On for 1st Earnings

Stock Rating  
Overweight

Industry View  
In-Line

Price Target  
\$23.00

With sports and state legislatures largely on hold, and DKNG a long-term story, we see 1Q20 earnings as less significant than future ones. However, with significant momentum in the stock, we lay out 4 key areas of focus for us.

**1) Loss trajectory.** We forecast a 1Q EBITDA loss of \$(34)m, and a loss of \$(139)m in 2020, vs. \$(82)m in 2019. With most major sports leagues halting their seasons in mid-March, and March Madness getting cancelled 5 days before the event (so likely some marketing dollars were already spent), we expect 1Q losses to be significant. Thinking forward to 2Q, despite broad sporting event cancellations DKNG has not announced lay-offs or furloughs, but the company has likely now pulled back on marketing, so we forecast a loss of \$(36)m. We will focus on commentary around 2020, including sensitivity to various outcomes such as NFL returning later than expected or not returning for the '19/'20 season, which could have a meaningful impact on DKNG's DFS business. The company has given limited historical quarterly disclosure but under pre-COVID conditions, 3Q would generally have the highest losses as operators market aggressively in the lead-up to NFL season, though this year 3Q could benefit from NBA Playoffs.

With pro forma combined (post-deal) cash of ~\$590m at YE19 (incl. \$44.5m drawn revolver, which it repaid in April), we would be comfortable with DKNG losing more than our \$(139)m '20 EBITDA forecast. However, if losses are expected to be >\$250m, it could suggest a shorter cash burn window and potential for a capital raise. That said, with its market cap at \$9B, DKNG could double its liquidity position while diluting shareholders by <10%.

**2) Updates to its revenue outlook.** At its March 2020 [Analyst Day](#), DKNG projected \$540m revenue in 2020, counting states that were live at the end of 2019 (so ~10% of US population with online sports betting, excluded IA), but also not considering headwinds from COVID-19. Its projection included iGaming in PA, which launched 5/1, and in NJ, both of which we expect are tracking ahead of mgmt's expectations due to stay-at-home tailwinds. Mgmt had also projected 2021 revenue of \$700m, which assumed OSB available to ~20% of the US population, and iGaming available to an additional 4% (beyond PA and NJ). Factoring in the impact of COVID, we forecast lower 2020 / 2021 revenue of \$439m / \$674m. We expect mgmt to lower expectations for this year due to COVID-19 but investors should be prepared for it. In 2019, DKNG reported pro forma revenue of \$432m, 4% ahead of its \$415m projection from December '19,

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## DraftKings Inc ( DKNG.O, DKNG US )

Gaming &amp; Lodging / United States of America

<b>Stock Rating</b>	<b>Overweight</b>
<b>Industry View</b>	<b>In-Line</b>
<b>Price target</b>	<b>\$23.00</b>
Shr price, close (May 13, 2020)	\$25.86
Mkt cap, curr (mm)	\$8,704
52-Week Range	\$28.15-9.76

Fiscal Year Ending	12/19	12/20e	12/21e	12/22e
<b>ModelWare EPS (\$)</b>	<b>(0.42)</b>	<b>(0.42)</b>	<b>(0.34)</b>	<b>(0.29)</b>
<b>Prior ModelWare EPS (\$)</b>	-	-	-	-
<b>P/E</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>
<b>EPS (\$)<sup>§</sup></b>	<b>-</b>	<b>(0.60)</b>	<b>(0.56)</b>	<b>(0.47)</b>
<b>Div yld (%)</b>	-	-	-	-

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework

§ = Consensus data is provided by Thomson Reuters Estimates  
e = Morgan Stanley Research estimates

## QUARTERLY MODELWARE EPS (\$)

Quarter	2019	2020e Prior	2020e Current	2021e Prior	2021e Current
Q1	-	-	(0.11)	-	-
Q2	-	-	(0.11)	-	-
Q3	-	-	(0.11)	-	-
Q4	-	-	(0.10)	-	-

e = Morgan Stanley Research estimates

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so DKNG has a recent track record of beating (normal) expectations.

**3) Commentary around recent trends.** While there are limitations on how much one can read into the current environment, we expect mgmt to highlight recent events that show strong pent-up demand for sports betting / DFS, as well as stay-at-home benefits to iGaming. There were two notable sporting events in April, the West Palm Beach tennis tournament, and UFC 249, which we expect mgmt to comment on. According to [The Action Network](#), UFC 249 was DKNG's most bet-on MMA event in its history before the main card even started, and we [found](#) US sports betting app downloads improved throughout the month of April, with declines of (34)% y/y the first week but growth of 32% the 4th. Looking ahead, there are star-studded charity golf matches 5/17 and 5/24, NASCAR returns 5/17, MLB owners tentatively [approved](#) a July return, NBA will have 22 of 30 practice facilities open by Monday ([report](#)), with potential for a summer playoffs, the PGA resumes 6/11, and Formula 1 potentially resumes in early July.

In terms of iGaming, NJ revenue increased 118% y/y to \$80m in April vs. +66% in March/+64% in February, with DraftKings' license holder growing 126%. In PA, [VIXIO GamblingCompliance reported](#) that revenue grew to >\$40m in April, implying >60% growth m/m, a strong acceleration vs. +25% in March and +40% in Feb. Notably DKNG launched iGaming in PA on 5/1. Generally there appears to be pent-up demand for gaming, with SD casinos reopening this past weekend and 1 CEO highlighting how volumes were 15-20% higher than a typical weekend. In addition, it has been reported that lotteries in GA and AR set new monthly records in April.

**4. Regulatory outlook.** While DKNG likely has more limited visibility into the near-term regulatory path for new sports betting and iGaming states as it typically would as COVID has interrupted typical legislative sessions, we still expect mgmt to address the outlook. Investors will be curious given it provides the building blocks to the sizeable market opportunity. For sports betting, we note bills have been advancing through the LA legislature. MD and SD both approved sports betting legalization questions to be placed on their November ballots. MI and IL launched onground sports betting in March shortly before casino closures, though we don't have much clarity around when online will launch (we forecast 2021 for both). In March-April, WA and OK authorized certain tribes to offer sports betting, while VA legalized sports betting on 4/23. Four operators (DraftKings, FanDuel, BetMGM, BetRivers) launched online sports betting on 5/1 in CO, a market we expect to be competitive due to its just 10% tax rate and 4m adults in the state. We forecast OH to legalize sports betting in 2020 as its session continues throughout the year. In iGaming, WV's Lottery Commission has approved rules that may allow iGaming to launch this summer vs. prior expectations/our forecast of 2021. Headlines suggest MI iGaming may launch sooner than our 2021 forecast if the Governor uses an emergency order, though legal challenges have limited its momentum. PENN (who operates in 19 states) on its 1Q earnings call highlighted discussions with states around legalizing/accelerating iGaming are "very active".

**For our more detailed views on DraftKings, please see our recent initiation, [All In on Best-in-Breed Sports Betting](#).**

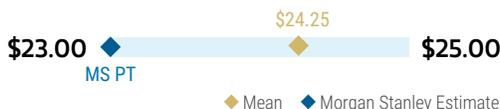
## Risk Reward – DraftKings Inc (DKNG.O)

Best-In-Breed for US Sports Betting, OW

### PRICE TARGET \$23.00

- Equal to base case scenario, discounting back 16x '25 EBITDA, based on comparable tech multiples

#### Consensus Price Target Distribution



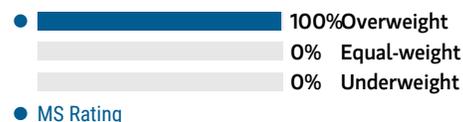
### RISK REWARD CHART



### OVERWEIGHT THESIS

- We expect legal US sports betting & iGaming to increase from <\$1.5B in 2019 to \$12B in 2025, with COVID-19 increasing the mkt opportunity as states look for new sources of tax revenue
- Forecast DraftKings to maintain leading #1/#2 share, 20% in sports betting and 15% in iGaming in 2025
- CAC advantage through its legacy Daily Fantasy Sports (DFS) database and improving marketing efficiency drives 29%/34% 2025/2028 EBITDA margins
- Regression of growth vs. valuation suggests DraftKings should trade at a 16x '25 EBITDA, which we then discount back
- Very attractive bull/bear skew

#### Consensus Rating Distribution



#### BULL CASE

**\$75.00**

**\$22B '25 TAM; DraftKings takes outsized share**

\$22B 2025 Gaming TAM (\$15B sports betting, (all states / \$60 spend per adult), \$7B iGaming (13 states / \$112 spend per adult), \$545m DFS), 25% Market Share, 34% EBITDA Margin, 20x EBITDA Multiple

#### BASE CASE

**\$23.00**

**\$12B '25 TAM; DraftKings remains a #1/#2 player**

\$12B 2025 Gaming TAM (\$8.5B sports betting (38 states / \$38 spend per adult), \$3.5B iGaming (11 states / \$81 spend per adult), \$436m DFS), 20% Market Share, 29% EBITDA Margin, 16x EBITDA Multiple Discounted back to YE20

#### BEAR CASE

**\$4.00**

**\$5B '25 TAM; DraftKings loses share**

\$5B 2025 Gaming TAM (\$3B sports betting (25 states / \$25 spend per adult), \$2B iGaming (6 states / \$63 spend per adult), \$327m DFS), 16% Market Share, 24% EBITDA Margin, 10x EBITDA Multiple

## Risk Reward – DraftKings Inc (DKNG.O)

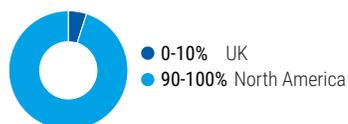
### KEY EARNINGS INPUTS

Drivers	2019	2020e	2021e	2022e
Sports Betting Market Growth (%)	114.5	8.2	88.7	69.9
Sports Betting Market Share (%)	11.2	17.6	17.1	18.3
Revenue Growth (%)	41.0	1.7	53.5	44.6
EBITDA Margin (\$, mm)	(0)	(0)	(0)	(0)

### INVESTMENT DRIVERS

- Sports betting, iGaming, and DFS TAM
- DraftKings' Market share
- Marketing (CAC vs. LTV) efficiency

### GLOBAL REVENUE EXPOSURE



Source: Morgan Stanley Research Estimate  
View explanation of regional hierarchies, [here](#)

### RISKS TO PT/RATING

#### RISKS TO UPSIDE

- Larger population legalizes online sports betting / iGaming
- DraftKings takes outsized market share
- Favorable regulatory developments
- Outperformance on costs

#### RISKS TO DOWNSIDE

- Legislative momentum for sports betting / iGaming slows
- Competition successful with being more promotional
- Unfavorable regulatory developments
- Outsized EBITDA losses
- COVID-19 drives extended sporting event cancellations
- Class A/B structure

### OWNERSHIP POSITIONING

Inst. Owners, % Active 91.7%

Source: Thomson Reuters, Morgan Stanley Research

### MS ESTIMATES VS. CONSENSUS

FY Dec 2020e

**Sales / Revenue (\$, mm)** ◆ 439  
Note: There are not sufficient brokers supplying consensus data for this metric

**EBITDA (\$, mm)** ◆ (159)  
Note: There are not sufficient brokers supplying consensus data for this metric

**EPS (\$)** ◆ (0.42)  
Note: There are not sufficient brokers supplying consensus data for this metric

◆ Mean ◆ Morgan Stanley Estimates

Source: Thomson Reuters, Morgan Stanley Research

# Model Summary - DraftKings Inc

Exhibit 1: Income Statement

Income Statement (\$ in millions)	2019	1Q20E	2Q20E	3Q20E	4Q20E	2020E	2021E	2022E	2023E	2024E	2025E
<b>Revenue</b>											
DraftKings	\$323	\$89	\$33	\$82	\$144	\$349	\$564	\$856	\$1,294	\$1,718	\$2,078
SBTech	108	23	14	22	30	90	110	118	129	141	152
<b>Revenue</b>	<b>\$432</b>	<b>\$113</b>	<b>\$48</b>	<b>\$104</b>	<b>\$175</b>	<b>\$439</b>	<b>\$674</b>	<b>\$974</b>	<b>\$1,423</b>	<b>\$1,858</b>	<b>\$2,229</b>
YY Growth %	41%	19%	-42%	9%	9%	2%	54%	45%	46%	31%	20%
% of Annual		26%	11%	24%	40%						
<b>Guidance</b>	<b>\$415</b>					<b>\$540</b>	<b>\$700</b>				
Cost of Revenue	(\$179)	(\$59)	(\$30)	(\$57)	(\$91)	(\$237)	(\$325)	(\$467)	(\$680)	(\$863)	(\$1,001)
<b>Gross Profit</b>	<b>\$253</b>	<b>\$54</b>	<b>\$18</b>	<b>\$47</b>	<b>\$84</b>	<b>\$202</b>	<b>\$349</b>	<b>\$508</b>	<b>\$743</b>	<b>\$995</b>	<b>\$1,228</b>
YY Growth %	17%					-20%	73%	45%	46%	34%	23%
Margin	58%	48%	37%	45%	48%	46%	52%	52%	52%	54%	55%
<b>Guidance</b>											
<b>Expenses</b>											
Sales & Marketing	(\$193)	(\$47)	(\$14)	(\$42)	(\$67)	(\$169)	(\$268)	(\$393)	(\$482)	(\$428)	(\$365)
Product & Technology	(76)	(20)	(19)	(22)	(26)	(87)	(96)	(103)	(109)	(114)	(120)
General & Administrative	(131)	(35)	(35)	(35)	(36)	(141)	(144)	(149)	(154)	(159)	(164)
<b>Total Operating Expenses</b>	<b>(\$400)</b>	<b>(\$102)</b>	<b>(\$67)</b>	<b>(\$99)</b>	<b>(\$128)</b>	<b>(\$397)</b>	<b>(\$508)</b>	<b>(\$645)</b>	<b>(\$744)</b>	<b>(\$702)</b>	<b>(\$649)</b>
YY Growth %						-1%	28%	27%	15%	-6%	-7%
% of Revenue	93%	90%	142%	95%	74%	90%	75%	66%	52%	38%	29%
Income From Operations	(\$148)	(\$48)	(\$50)	(\$52)	(\$45)	(\$195)	(\$159)	(\$137)	(\$1)	\$293	\$579
Interest Income (Expense)	1	0	0	0	0	1	1	1	1	1	1
Other	3	-	-	-	-	-	-	-	-	-	-
<b>Income Before Tax</b>	<b>(\$144)</b>	<b>(\$48)</b>	<b>(\$49)</b>	<b>(\$52)</b>	<b>(\$44)</b>	<b>(\$194)</b>	<b>(\$157)</b>	<b>(\$136)</b>	<b>(\$0)</b>	<b>\$294</b>	<b>\$580</b>
Income Tax Benefit (Expense)	\$4	\$12	\$12	\$13	\$11	\$48	\$39	\$34	\$0	(\$74)	(\$145)
Other	(0)	-	-	-	-	-	-	-	-	-	-
<b>Net Income</b>	<b>(\$140)</b>	<b>(\$36)</b>	<b>(\$37)</b>	<b>(\$39)</b>	<b>(\$33)</b>	<b>(\$145)</b>	<b>(\$118)</b>	<b>(\$102)</b>	<b>(\$0)</b>	<b>\$221</b>	<b>\$435</b>
Avg. Shares Outstanding (No Redemption)	337	337	350	350	350	347	350	350	350	350	350
Avg. Shares Outstanding (Max Redemption)	306	306	306	306	306	306	306	306	306	306	306
<b>Earnings Per Share (No Redemption)</b>	<b>(\$0.42)</b>	<b>(\$0.11)</b>	<b>(\$0.11)</b>	<b>(\$0.11)</b>	<b>(\$0.10)</b>	<b>(\$0.42)</b>	<b>(\$0.34)</b>	<b>(\$0.29)</b>	<b>(\$0.00)</b>	<b>\$0.63</b>	<b>\$1.24</b>
<b>Earnings Per Share (Max Redemption)</b>	<b>(\$0.46)</b>	<b>(\$0.12)</b>	<b>(\$0.12)</b>	<b>(\$0.13)</b>	<b>(\$0.11)</b>	<b>(\$0.47)</b>	<b>(\$0.39)</b>	<b>(\$0.33)</b>	<b>(\$0.00)</b>	<b>\$0.72</b>	<b>\$1.42</b>
<b>Adjusted EBITDA Build</b>											
Income From Operations	(\$148)	(\$48)	(\$50)	(\$52)	(\$45)	(\$195)	(\$159)	(\$137)	(\$1)	\$293	\$579
D&A	32	9	9	9	9	36	35	37	36	35	35
Stock-based Compensation	18	5	5	5	5	20	22	23	24	25	27
Transaction-related & Other	17	-	-	-	-	-	-	-	-	-	-
<b>Consolidated Adjusted EBITDA</b>	<b>(\$82)</b>	<b>(\$34)</b>	<b>(\$36)</b>	<b>(\$38)</b>	<b>(\$31)</b>	<b>(\$139)</b>	<b>(\$101)</b>	<b>(\$77)</b>	<b>\$59</b>	<b>\$354</b>	<b>\$640</b>
YY Growth %						69%	-27%	-24%	-176%	500%	81%
Margin	-19%	-30%	-75%	-37%	-18%	-32%	-15%	-8%	4%	19%	29%
<b>Guidance</b>											

Source: Company Reports, Morgan Stanley Research estimates

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(as of April 30, 2020)

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	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MISC
<b>Overweight/Buy</b>	<b>1216</b>	<b>38%</b>	<b>300</b>	<b>42%</b>	<b>25%</b>	<b>533</b>	<b>37%</b>
<b>Equal-weight/Hold</b>	<b>1432</b>	<b>45%</b>	<b>325</b>	<b>46%</b>	<b>23%</b>	<b>698</b>	<b>48%</b>
<b>Not-Rated/Hold</b>	<b>3</b>	<b>0%</b>	<b>1</b>	<b>0%</b>	<b>33%</b>	<b>3</b>	<b>0%</b>
<b>Underweight/Sell</b>	<b>553</b>	<b>17%</b>	<b>81</b>	<b>11%</b>	<b>15%</b>	<b>220</b>	<b>15%</b>
<b>TOTAL</b>	<b>3,204</b>		<b>707</b>			<b>1454</b>	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

### Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

### Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

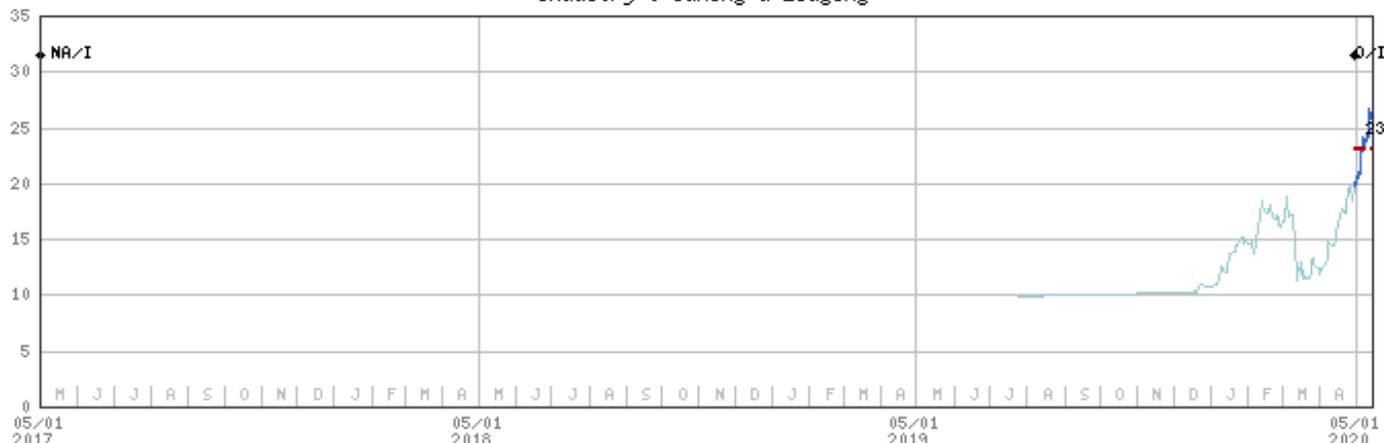
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

### Stock Price, Price Target and Rating History (See Rating Definitions)

DraftKings Inc (DKNG.O) - As of 5/13/20 in USD  
Industry : Gaming & Lodging



Stock Rating History: 5/1/15 : NA/A; 3/16/16 : NA/I; 4/30/20 : O/I

Price Target History: 4/30/20 : 23

Source: Morgan Stanley Research      Date Format : MM/DD/YY      Price Target --      No Price Target Assigned (NA)  
 Stock Price (Not Covered by Current Analyst) —      Stock Price (Covered by Current Analyst) ■  
 Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View  
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)  
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.  
 Effective January 13, 2014, the industry view benchmarks for Morgan Stanley Asia Pacific are as follows: relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

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## INDUSTRY COVERAGE: Gaming &amp; Lodging

COMPANY (TICKER)	RATING (AS OF)	PRICE* (05/13/2020)
<b>Thomas Allen</b>		
Boyd Gaming Corporation (BYD.N)	O (12/20/2018)	\$15.38
Caesars Entertainment Corp (CZR.O)	E (06/25/2019)	\$9.61
Choice Hotels International Inc (CHH.N)	E (05/05/2017)	\$68.65
DiamondRock Hospitality Co (DRH.N)	U (09/26/2016)	\$4.29
DraftKings Inc (DKNG.O)	O (04/30/2020)	\$25.86
Eldorado Resorts Inc. (ERI.O)	O (11/18/2019)	\$20.28
Extended Stay America Inc (STAY.O)	E (08/09/2019)	\$10.25
Gaming and Leisure Properties Inc (GLPI.O)	O (07/24/2018)	\$25.90
Hilton Worldwide Holdings Inc (HLT.N)	E (01/17/2018)	\$64.85
Host Hotels & Resorts, Inc. (HST.N)	U (12/20/2018)	\$9.45
Hyatt Hotels Corporation (H.N)	E (03/07/2017)	\$44.35
Las Vegas Sands Corp. (LVS.N)	E (01/21/2020)	\$44.42
Marriott International Inc. (MAR.O)	E (07/24/2018)	\$75.26
MGM Growth Properties LLC (MGP.N)	E (01/21/2020)	\$21.96
MGM Resorts International (MGMN)	E (01/21/2020)	\$12.68
Penn National Gaming, Inc. (PENN.O)	O (05/09/2019)	\$16.54
Sunstone Hotel Investors Inc (SHO.N)	U (09/26/2016)	\$7.04
VICI Properties Inc (VICI.N)	O (08/26/2019)	\$14.87
Wynn Resorts, Limited (WYNN.O)	E (02/09/2018)	\$76.77
Xenia Hotels & Resorts Inc (XHR.N)	U (12/20/2018)	\$6.75

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\* Historical prices are not split adjusted.