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Growth Is Not Just Technology

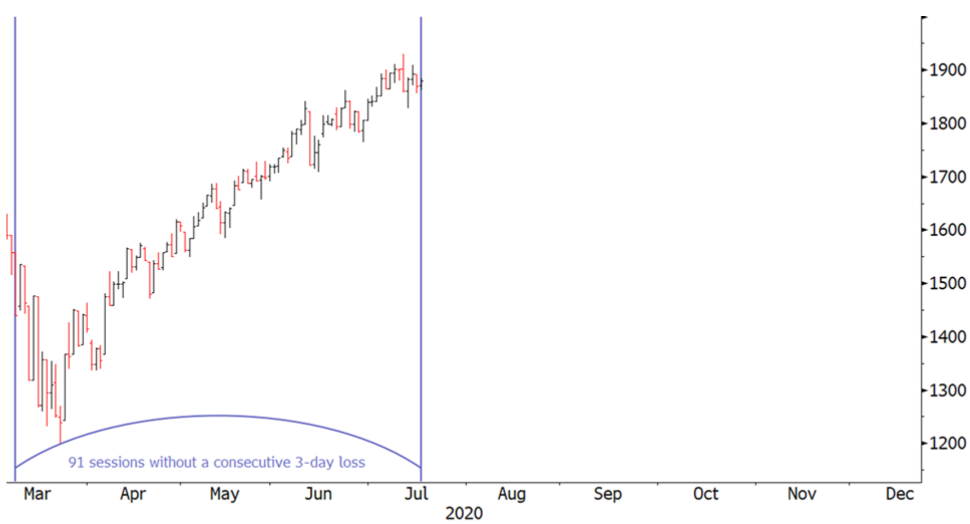
August 2020

Technology stocks, in particular the mega caps, have delivered impressive returns in 2020, despite the Covid-19 driven economic recession. Through the end of June, the shares of the three largest (by market value) companies in the US, Microsoft, Apple and Amazon were up 29%, 24%, and 49% respectively. Their success is well earned and is symptomatic of the continued migration of economic activity to a digital process. After this impressive run, each is worth more than $1.5 trillion in market value and together they are valued at roughly $5 trillion, which was the market value of the entire S&P 500 in 1997. While the returns from these stocks have been extraordinary and we have participated to some extent in all of them, they are likely due for a pause from their unrelenting march upward.

Below is a chart of the S&P 500 Technology Sector this year. This part of the market has had 91 consecutive sessions without experiencing three down days in a row. According to Cornerstone Macro, this has only happened once before in the history of the data set, which goes back to 1989. The bottom chart shows that occurrence, in 2004, and what followed.

We aren't bearish or betting against these dominant technology-driven companies, but remain mindful that we are focused not on just making investments, but on making investment returns. For the time being, we are finding more compelling opportunities elsewhere.

Title: S&P 500 Technology Sector



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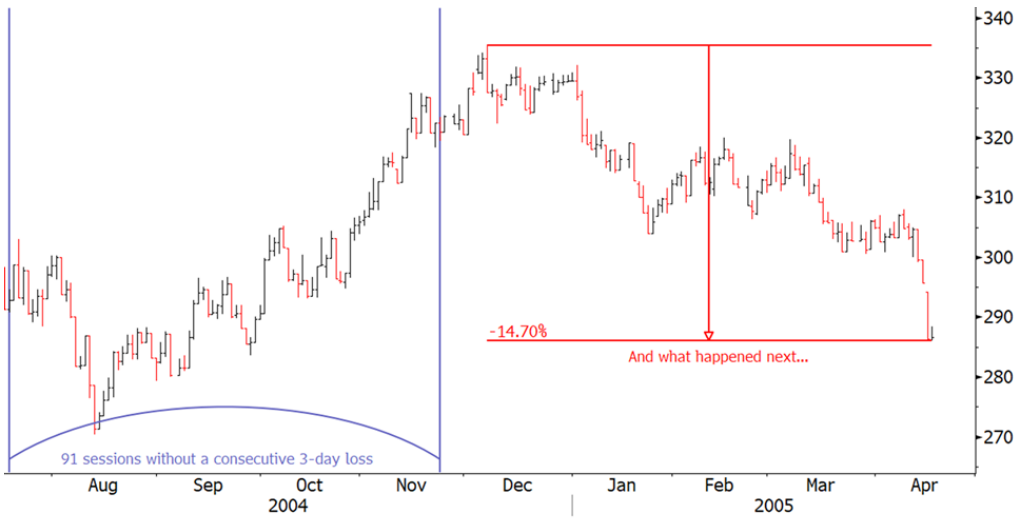

Source: Cornerstone Macro

BENEFICARIES OF ECONOMIC STRESS

A lingering effect of the economic shock driven by the Covid-19 pandemic is significant state budget deficits. A challenge state governments routinely face is a largely fixed cost base and a more volatile revenue base based on tax revenue. Economic stress occasionally leads states to look to industries on the periphery of legalization that are eager to trade regulation and higher taxes for government endorsement and industry expansion. The expansion of casino gambling and lotteries in the 1990s is a good case study that provides insight into what is likely to happen in this cycle. After the 1990 recession, eight states legalized riverboat casino gambling in the following four years. Politicians, reluctant to raise broad based income, sales or property taxes, found casinos as an acceptable alternative. Once a state legalizes, it often prompts neighboring states to consider legalizing as well, as politicians watch their citizens drive across the border to gamble, taking potential tax revenue with them. Two young industries benefitting from similar political motivation for alternative sources of tax revenue are digital sports betting and cannabis. Both of these industries are benefitting from recent legislative change and we anticipate a meaningful expansion for both over the next several years and have made investments positioned to benefit.

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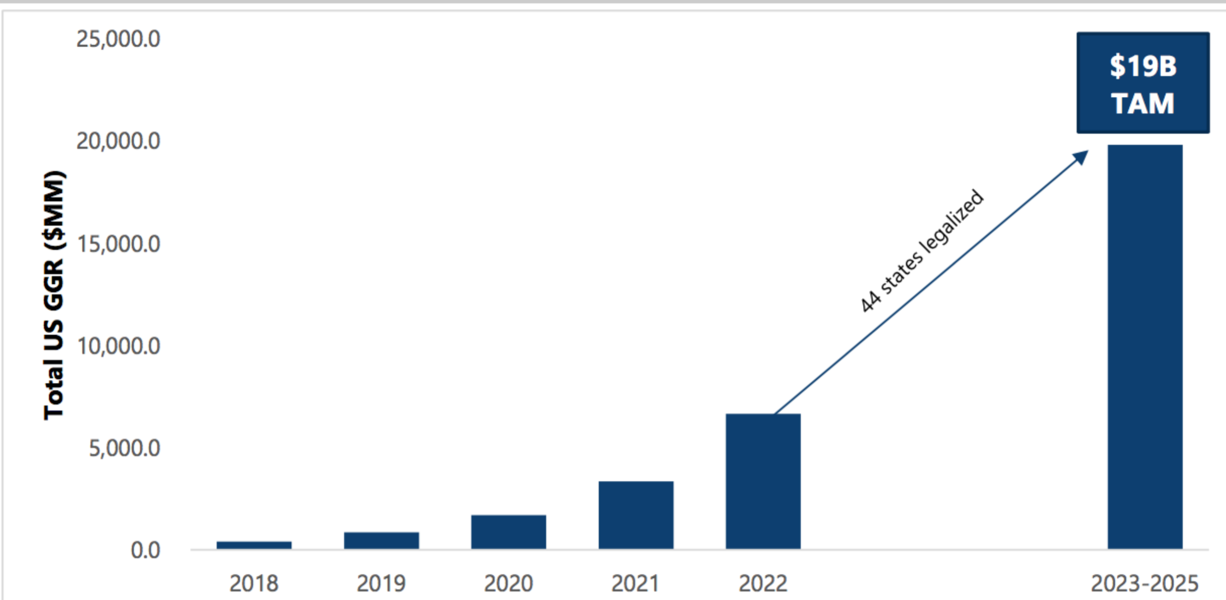
Online Gambling and Sports Betting

Online gambling, and in particular sports betting, has gained momentum since the Supreme Court struck down the federal sports betting ban in May 2018, permitting states to legalize sports gambling.

Eighteen states and the District of Columbia offer sports betting and four offer internet gambling, which can include online casino games, slots and poker.

Virginia and Tennessee have approved sports betting but have yet to launch while several other states are contemplating varying versions of gambling expansion. Only six states currently allow fully mobile sports betting, with the others still requiring a physical connection to a casino. Over the next five years, we expect a large majority of states will legalize full mobile sports betting, creating a significant tailwind for industry growth. The investment bank, Jefferies, estimates that industry revenue should grow rapidly over the next five years, to $19 billion from its current run rate of under $3 billion. As an indication of the pent-up demand for sports betting, current market leader Draftkings reported that the amount wagered on baseball's opening day game last week was a new record for a baseball game, eclipsing game seven of the 2019 World Series.

Chart 13 - US Sports Betting Notional Trajectory



Source: Jefferies Estimates

Penn National Gaming

Penn National is the largest US casino operator by the number of casinos, operating 41 casinos in 19 states. We believe Penn has an excellent competitive position and will become one of the leaders in online gambling and sports betting. Already licensed in 19 states with a player database of 20 million people, Penn has a nationwide footprint. Penn's management signaled its focus on the sports betting opportunity with the acquisition of 36% of Barstool Sports in January for $163 million. Barstool Sports is one of the largest sports media properties, with 66 million unique monthly users. Penn and Barstool have announced they will launch their sports betting app by this fall in time for the beginning of the NFL football season and Penn is in the process of rebranding all of its casino-based sports books to the Barstool brand. We believe the shares are reasonably priced today for just its existing casino business, with little value accrued for the soon to launch online sports betting business. Capturing 20% share of that market would double the company's current revenue over the next five years, driving significant value to its shares.

GAN – "Shopify" for Online Casinos

GAN Ltd is a software company that provides the entire software stack to online casinos, from the game, to player tracking, to accounting and regulatory reporting. The company is the clear market leader in the US market. GAN's intellectual property and patents, combined with the complexity and regulatory burden of the gambling industry create significant barriers to entry. As a one-stop-shop for launching and running an online gambling operation, GAN is comparable to how software company Shopify has enabled millions of retailers to move online. As compensation for its services, GAN typically earns a share of its clients' online revenue, which varies by client from roughly 5-10% of revenue. As a software company, management expects at least 60% of incremental revenue to flow through to profits and EBITDA profit margins above 30%. The company held its initial public offering in May and is still not widely followed.

What is interesting to us about GAN Ltd is its competitive position and opportunity for rapid growth as the technology backbone for an industry about to significantly expand. GAN is partnered with most of the leading operators and was the launch partner for market leader FanDuel in New Jersey in 2018 and is expanding with FanDuel's subsequent launches in Pennsylvania and Indiana. During its most recent earnings conference call in June, GAN announced that it reached an agreement with

> *"a Tier-1 client that is looking to deploy our game stack technology in new addressable states, such as Illinois, Tennessee, as well as Michigan and other states in which GAN*

offers considerable existing operating experience, such as New Jersey, Pennsylvania, and Indiana."

We believe that client is possibly Penn National Gaming, as the GAN CEO further went on to say this "very large retail and also online gambling enterprise" client will likely represent $300-$400 million in gross operating revenue annually at maturity. To put this type of deal in context, GAN's share of that revenue would likely be $15-25 million annually, compared to its expected revenue in total this year of roughly $40 million. With online sports betting just beginning its expansion, we anticipate more of this type of announcement over the coming quarters.

Cannabis

Cannabis is currently legal for medicinal use in 33 states plus the District of Columbia, and 11 of those states plus D.C. have approved "adult" use, often called recreational use, as well. During the upcoming November election, voters in at least seven states will likely have a cannabis initiative on the ballot. New Jersey will vote on expanding its current medicinal approval to adult use, Mississippi will vote on allowing medicinal use, and South Dakota will vote on both. Additionally, Arizona, Montana and Nebraska have submitted signatures to try to make the ballot to expand or begin authorizing cannabis in some form.

Other states are reacting to their neighbors' movement. For example, earlier this month, fifteen Pennsylvania State Senators sent a letter to the governor and heads of the state legislature urging the quick legalization of cannabis for adult use. The opening paragraph of the July 9th letter reads:

"We should do absolutely everything we can to raise revenue. That is why we come together as a committed group of Pennsylvania Senators to urge our leaders to take up the bi-partisan issue of adult-use cannabis legislation."

The momentum in this industry continues to build.

The GrowthLine Team

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