March 18, 2019

Drive Shack (DS: $4.54 Outperform; $7 PT)

Seasoned Management Team Chasing a Big Growth Opportunity; Stores Opening Soon Will Help Recast the Story—We Are Upgrading our Rating to Outperform from In-Line and Raising Our Price Target to $7 from $5

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Key Data

Symbol:	DS
Price (3/15/19):	$4.54
Rating:	Outperform
Price Target:	$7
Estimates:	
2019E Revenue:	$220
2020E Revenue:	$237
2019E Adj EV/Revenue:	1.1x
2020E Adj EV/Revenue:	1.0x

Company Description
Drive Shack is an early-stage golf entertainment business, with one location in operation and a pipeline of new stores under development.

Figure 1. Drive Shack—Key Company Data, Prices as of 3/15/19

Key Data		FY: Dec	2018E		2019E		2020E		2021E	
Price:	$4.54	GAAP EPS:	Old	New	Old	New	Old	New	Old	New
Price Target:	**$7.00**	Q1	(0.26)A	(0.26)A	--	(0.16)	--	(0.06)	--	--
52-Week Range:	$3.55-$8.06	Q2	(0.09)A	(0.09)A	--	(0.06)	--	(0.03)	--	--
Market Cap ($mn):	304	Q3	(0.09)	0.23A	--	(0.04)	--	(0.06)	--	--
Shares Out. (mn):	67	Q4	(0.15)	(0.07)A	--	(0.01)	--	(0.07)	--	--
Avg. Daily Vol.:	210,000	Year	(0.60)	(0.66)A	(0.40)	(0.28)	--	(0.23)	--	(0.26)
Total Debt & P/S($mn)*:	113	Operating Revenue ($mn)								
Net Debt ($mn)*:	34	Q1	67A	67A	--	55	--	49	--	--
		Q2	91A	91A	--	56	--	66	--	--
EV ($mn):	338	Q3	88	87A	--	59	--	64	--	--
Annual Dividend:	na	Q4	76	69A	--	50	--	58	--	--
Dividend yield:	na	Year	322	314A	332	220	--	237	--	284

Sources: Company data and Imperial Capital, LLC.

Financial Summary

Drive Shack, Inc. (DS) generated revenue of $314mn and net income of ($44mn) in the latest twelve months (LTM) ended 12/31/18. The company had approximately $79mn in cash and equivalents and $113mn in debt and preferred stock as of that date. Liquidity will improve with the sale of DS's remaining owned golf portfolio and legacy debt portfolio.

View and Valuation

We are raising our rating on DS shares to Outperform from In-Line and raising our one-year price target to $7 from $5, about 54% above the recent share price. Our price target is based on a sum-of-the-parts analysis (as explained on page 3).

Rationale

We are raising our rating to Outperform. We are optimistic that new venues opening this summer/fall will perform better than Orlando, and longer-term, we believe DS's seasoned management team will be able to navigate the rapidly growing golf entertainment space. The stock is attractive, in our view, given the many "hidden" balance sheet assets and big growth opportunity.

New management: DS announced several management changes in late-2018 and early-2019. Most important was the addition of Ken May, who served as CEO of Topgolf from 2013-2017 and held senior positions at FedEx and Krispy Kreme. David Hammarley joined as CFO after senior roles at sbe and Starwood. The senior team, which is now largely in place, includes others from Topgolf.

2019 new-stores: New stores in Raleigh and West Palm Beach appear better positioned than Orlando, which has generated weak results since opening in 2Q18. Both locations are more urban and face no proximate Topgolf venues. Richmond, which also opens later this year, is situated well outside downtown, but at least comes to market before Richmond Topgolf opens later in 2019. All-in, we believe the locations will give the Street more confidence in management's unit-level targets.

Raleigh is expected to open this summer. The location is approximately 7 miles from downtown Raleigh and *en route* to Durham and Chapel Hill. Topgolf does not operate in the area and the relatively small population of the greater-MSA might make it a one-venue town.

West Palm Beach is expected to open this summer. Topgolf's nearest locations are in the Miami area, approximately 60 miles south. A planned redevelopment proposal that would include Topgolf has been put on hold.

Capitalization

Figure 2. Drive Shack—Capitalization as of 12/31/18, Prices as of 3/15/19

LTM Revenue (12/31/18)		314	Debt Face		Net Debt Face		Net Debt Market			Price / YTM Analysis			Interest Exp. Analysis	
Settlement Date		NA	Cum. Debt Face	LTM EBITDA na Mult.	Net Cum. Debt Face	LTM EBITDA na Mult.	Debt Mkt	Net Cum. Debt Mkt	LTM EBITDA na Mult.	Price	YTM	Mat.	Rate/ Coup.	Est. Int. Exp.
	M/S&P Rating	Balance												
Cash		79												
Estimated Debt + Golf Monetizatic		210												
Senior Secured Credit Facility														
Junior Subordinated Notes		51	51									2035	2.84%	1.4
Pref Stock		62	62									2023	8.77%	5.4
Total		**113**	**113**											**6.8**
Common Equity														
Common Stock (DS)		304												
Total Equity		**304**			**304**		**4.54**	**67.0**					**Interest**	**6.8**

Sources: Company data and Imperial Capital, LLC.

Rationale (continued)

Richmond is expected to open this fall. The site is almost 20 miles from downtown. Topgolf, which is expected to open shortly after DS, is nearer to downtown and situated in a more popular district.

An aggressive store ramp in 2020 and beyond: DS plans to open 3-5 new sites in 2020 and 5-10 in 2021 and 2022. Planned openings include several attractive markets, including Chicago, Houston, New Orleans, New York, Newport Beach, and Portland. The company is focused on markets where Topgolf is not available/in-development, or select sites with attractive demographics. Management is currently focused on the U.S. but would consider international development over time.

New stores will be structured differently than Orlando – often smaller and more focused around a central bar/restaurant (as has been successful at Topgolf). The staffing/menus/branding are also likely to change.

Management expects new stores to cost $20-35mn, depending on the size/market, and generate $15-25mn in sales and 25-30% EBITDA margin. Time to breakeven/profitability is uncertain.

Balance sheet will support near-term development pipeline: DS ended 2018 with approximately $80mn in cash. After factoring near/long-term golf course sales, it expects to have $180-200mn in liquidity available for new-builds. Its legacy debt portfolio could yield approximately $70mn in incremental proceeds, and we believe the managed golf course portfolio, which is expected to generate $10mn of annual cash flow in 2020, could also be a source of value.

The $180-200mn of liquidity will fund the company through mid-2020, at which time it will pursue debt financing or alternative funding. We believe an equity raise is not of-interest; a unique partnership/funding agreement is more likely in our opinion. Topgolf has utilized a major REIT (EPR; not rated) to fund many of its sites. We also wonder if Fortress or Wes Edens (the original sponsor and Chairman of the Board) would commit additional capital. Mr. Edens bought stock in the open market several times in 2017 and 2018 at/below $6.00.

Figure 3 below tracks our expectations for the entertainment segment and consolidated cash flows. We model for three new locations in 2019 and 2020 and no new locations in 2021, which is unlikely (but would necessitate additional financing or asset sales). As shown, our model has cash bottoming in mid-2020 and has store-level EBITDA growing to $25mn in 2021 from the base of seven stores. Please contact your Imperial Capital sales representative for a more detailed model.

Figure 3. Drive Shack—Tracking the Entertainment Segment, 2Q18-2021E

	2018	Q1	Q2	Q3	Q4	2019E	Q1	Q2	Q3	Q4	2020E	2021E
Revenue	4,947	1,800	1,800	6,600	9,300	19,500	11,850	16,850	16,650	21,850	67,200	113,700
Store Level EBITDA	713	250	250	1,400	2,200	4,100	3,100	3,300	3,600	5,500	15,500	25,150
Entertainment Capex	70,517	25,250	25,250	20,250	21,750	92,500	28,150	25,650	8,150	4,150	66,100	4,600
Cash	79,235	74,340	64,145	58,450	51,455	51,455	29,510	10,065	8,120	11,675	11,675	10,045

Sources: Company data and Imperial Capital, LLC.

Attractive valuation: DS has been volatile because the market has struggled to gain confidence around unit economics. We believe confidence will grow with the opening of new locations, at which time the stock will be valued on a multiple of store-level EBITDA.

Our model below sets up that scenario. The columns represent today's valuation (left column) and a one-year scenario at our $7 price target (right column). Our $7 price target assumes that DS will carry a 15x forward store-level EBITDA multiple at this time next year. As mentioned above, we believe investors will increasingly value the company based on forward store-level projections following the new store openings this summer/fall.

Figure 4. Drive Shack—Understanding Valuation at Today's Price and Our Price Target

Price	4.50	7.00
Market Cap	301,397	468,840
Managed Course Port	100,000	100,000
Net Cash	36,446	(13,273)
Adj EV	164,951	382,113
'21 Store Level EBITDA	25,150	25,150
'21 Store Level Revenue	113,700	113,700
Adj EV/EBITDA	6.6	15.2
Adj EV/Revenue	1.5	3.4

Sources: Company data and Imperial Capital, LLC.

Store level economics are challenging to model, but we do have more comfort now given the background of the current management team. CEO Ken May ran Topgolf for four years and understands the store-level economics.

Competitive dynamics are challenging, but we see room for more than one operator: Topgolf is a formidable competitor. It carries balance sheet power (it has secured several rounds of debt and equity financing, it partners with a major REIT, and it has several well-capitalized owners), a strong and growing base of stores, and an exciting technology platform that integrates with ancillary businesses. We estimate that it generated nearly $800mn in 2018 revenue on 17mn guest visits.

With that said, in much of the U.S. and world golf entertainment is unavailable. As shown below, there are still 22 states without a venue and many major metros with only one.

Texas, which houses 11 Topgolf venues, shows what kind of density is possible. Texas does benefit from favorable weather and inexpensive land, but the example is valuable nonetheless.

Figure 5. Drive Shack—Understanding Valuation at Today's Price and Our Price Target

	DS	TG		DS	TG		DS	TG
AL	0	2	LA	1	1	OH	0	3
AK	0	0	ME	0	0	OK	0	1
AZ	0	4	MD	0	3	OR	1	1
AR	0	0	MA	0	0	PA	0	1
CA	1	2	MI	0	1	RI	0	0
CO	0	2	MN	0	1	SC	0	2
CT	0	0	MS	0	0	SD	0	0
DE	0	0	MO	0	1	TN	0	1
FL	2	5	MT	0	0	TX	1	11
GA	0	2	NE	0	0	UT	0	1
HI	0	0	NV	0	1	VT	0	0
ID	0	0	NH	0	0	VA	1	4
IL	1	3	NJ	0	2	WA	0	0
IN	0	1	NM	0	1	WV	0	0
IA	0	0	NY	1	0	WI	0	0
KS	0	1	NC	1	1	WY	0	0
KY	0	0	ND	0	0	**Total**	**10**	**59**

Sources: Company data and Imperial Capital, LLC.

Aside from Topgolf and Drive Shack, there are no other competitors with more than one location. Flying Tee operates outside Tulsa but has been unable to grow locations since launching in 2016. BigShots Golf operates a location in Vero Beach and is franchising additional locations. It is owned by ClubCorp.

Figure 6. Drive Shack—Income Statement, 2018-2021E

Drive Shack, Inc. (DS)	2018	1Q19E March	2Q19E June	3Q19E Sept	4Q19E Dec	2019E	1Q20E March	2Q20E June	3Q20E Sept	4Q20E Dec	2020E	2021E
Net Interest Income	(11,965)	0	0	0	0	0	0	0	0	0	0	0
Total Operating Revenue	314,369	55,128	56,402	59,051	49,912	220,493	49,180	65,992	63,856	58,400	237,428	283,928
Growth	*7.4%*	*-17.3%*	*-38.0%*	*-32.5%*	*-28.0%*	*-29.9%*	*-10.8%*	*17.0%*	*8.1%*	*17.0%*	*7.7%*	*19.6%*
Expenses	340,803	64,494	59,375	60,361	49,376	233,606	51,680	66,921	66,875	61,918	247,394	296,244
Pretax Income	(38,399)	(9,366)	(2,973)	(1,309)	536	(13,113)	(2,501)	(929)	(3,019)	(3,517)	(9,966)	(12,316)
Income Taxes	284	0	0	0	0	0	0	0	0	0	0	0
Rate	*-0.7%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Disc Ops	0	0	0	0	0	0	0	0	0	0	0	0
Net Income	(38,683)	(9,366)	(2,973)	(1,309)	536	(13,113)	(2,501)	(929)	(3,019)	(3,517)	(9,966)	(12,316)
Pref Dividends	(5,580)	(1,395)	(1,395)	(1,395)	(1,395)	(5,580)	(1,395)	(1,395)	(1,395)	(1,395)	(5,580)	(5,580)
Noncontrolling Interests	0	0	0	0	0	0	0	0	0	0	0	0
Net Income	(44,263)	(10,761)	(4,368)	(2,704)	(859)	(18,693)	(3,896)	(2,324)	(4,414)	(4,912)	(15,546)	(17,896)
GAAP EPS	(0.66)	(0.16)	(0.06)	(0.04)	(0.01)	(0.28)	(0.06)	(0.03)	(0.06)	(0.07)	(0.23)	(0.26)
Diluted Shares Outstanding	66,993	67,277	67,527	67,777	68,027	67,652	68,277	68,527	68,777	69,027	68,652	69,652
Store Level EBITDA	713	250	250	1,400	2,200	4,100	3,100	3,300	3,600	5,500	15,500	25,150

Sources: Company data and Imperial Capital, LLC.

Risk Factors

- **Golf industry:** The industry remains challenged, although there are signs it has bottomed.
- **Drive Shack concept:** The financial profile of a store is immature.
- **Cash burn:** The company has historically burned cash.
- **Technology:** DS is competing against Topgolf, which has more IT capabilities, properties, and capital.

Price Chart and Ratings History

Figure 7. Drive Shack—Price Chart and Ratings History

Description	Price	IC Rating	Report Date
Common Stock	$6.01	In-Line	9/5/18
Common Stock	$5.15	In-Line	4/26/18
Common Stock	$3.61	In-Line	11/2/17
Common Stock	$2.89	In-Line	8/3/17
Common Stock	$3.60	In-Line	5/17/17
Common Stock	$4.17	In-Line	3/1/17
Common Stock	$4.31	In-Line	12/12/16
Common Stock	$4.54	In-Line	11/8/16

Sources: Bloomberg and Imperial Capital, LLC.

Companies under coverage: George Kelly, CFA: Acushnet Holdings (GOLF), Brunswick Corporation (BC), Callaway Golf Company (ELY), Drive Shack (DS), Freshpet (FRPT), Haymaker Acquisition (HYAC), Johnson Outdoors (JOUT), Lindblad Expeditions (LIND), MINDBODY (MB), National Beverage (FIZZ), Nautilus (NLS), Planet Fitness (PLNT), Primo Water (PRMW), Town Sports International Holdings (CLUB), YogaWorks (YOGA).

Important Disclosures, Certifications and Other Information

Ratings Distribution and Definitions

Equity Ratings Definitions (as of 7/1/09)		
Outperform	65.29%	**Outperform**: TRR expected to exceed basket by at least 10%
In-Line	29.75%	**In-Line**: TRR expected to be in-line with basket
Underperform	4.96%	**Underperform**: TRR expected to underperform basket by at least 10%

This Equity Ratings Distribution reflects the percentage distribution for rated equity securities for the twelve month period 1/1/18 through 12/31/18. Rating definitions are expressed as the total rate of return (TRR) relative to the expected performance of a basket of like securities over a 12-month period. Within the twelve month period ended 12/31/18, IC has provided investment banking services to 12.66% of companies with equity rated an Outperform, 0.00% of companies with equity rated an Underperform, and 11.11% of companies with equity rated an In-Line. As of 12/31/18.

Fixed Income Ratings Definitions and Equity Ratings Definitions (prior to 7/1/09)

Buy: TRR expected to exceed basket by at least 10%
Hold: TRR expected to be in-line with basket
Sell: TRR expected to underperform basket by at least 10%

Rating definitions are expressed as the total rate of return (TRR) relative to the expected performance of a basket of like securities over a 12-month period. Please refer to our publication dated 7/1/09 for details associated with the transition of our Equity Ratings to the current definitions.

For a discussion of the valuation methods used to determine our price target, if any, please see pages 1 and 3. See page 5 for the risks that may impede achievement of such price target, and page 5 for our ratings history and price chart.

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