

Todd Bonner Interview 01

Marin Katusa: Hi. It's Marin Katusa here. I'm going to talk about a sector today that's going to be bigger than the whole crypto-currency sector, the whole cannabis sector, both of those combined. You may have never heard of it, but your children and your grandchildren have.

In fact, there are games out there, like The League of Legends, which sell out stadiums, over 80,000 people, to watch the stars, the eSports stars of this sector.

This is bigger than anything I have seen in my career. When you think about it, such that the 2017 finals had two times more viewers than the NBA finals, let's really pay attention to that. More people are watching eSport athletes play games online, than all of the NBA finals! This is a new trend in motion.

There are online streamers, such as Twitch. Again, you may have never heard of this. But they have more viewers daily, than the traditional media combined.

And this is a growing trend, when you think about 15 million daily users watching other people play games. It's not just about playing the game, which is a big part of the sector. It's also about watching others play the game. It's a whole new genre moving together.

Tencent is kind of the gorilla at the center of the chessboard. They own a big percentage of Epic games, which right now has the world's most famous game, called Fortnite. This game has made over \$1.5 billion, and makes hundreds of millions of dollars a month.

If you take all of the senior gold producers and combine them together, this one game makes more money than all of the gold producers, combined. This is why I want you to pay attention.

The old model used to be you go to the store, you buy a video game, and you play it in your console. That's the old model. It's still there, but it's nowhere near where the market is going. Now, it's all about microtransactions. That's how games such as Fortnite are making billions of dollars.

Today, I'm lucky to have Todd, who is the CEO, and has spent nearly two decades in this sector, and is really one of the innovators in this sector.

Todd, I thank you for doing this. Let's go back into why microtransactions, how did it come about, and why it's so important moving forward.

Todd Bonner: There was a reluctance in the Asian market, especially China, to pay for downloadable content, which is called the DLC model, which was the norm in the west, and still largely is.

Starting with Korean games moving into China, they found that people actually pay more per month, higher RPU's per month, paying for items in the game, rather than the downloads.

Marin Katusa: Such as weapons and skins and jerseys.

Todd Bonner: Exactly. Yes, sir.

Marin Katusa: These are things that, 20 years ago, nobody would have ever thought of. Let's go back to how this happened.

In China, they were worried about the North American consoles taking over, so they put restrictions on that. That's how the PC – so, explain to the audience about that.

Todd Bonner: It was really driven by connectivity. I think that was the primary driver. I used to work for a telecom company, and we were told to buy – I won't name the company – but a public company in Korea that was a DSL provider, a broadband provider.

We looked at, what are the top two utilizations? What were the packets doing? What were people doing at home? It was pornography, number one, and video games, number two. The first online games had just started coming out – Ultima Online.

What we noticed was that connectivity was going to expand, obviously, into China. They were fiberizing up China. Korea actually had 22% broadband penetration in the year 2000. China was already planning on large fiberoptic backbones throughout the country; north, south, east, west – and they did so.

That drove the online game, initially, through the PC platform, into the Chinese market. But the Chinese were unwilling to pay for downloadable content. It was obviously an emerging market, back then. It's not so much an emerging market anymore.

That immediately proved the model. It started with the Korean games actually transferring into China, like Lineage, for example.

Marin Katusa: Today, Tencent is the center of the chessboard. The reason I bring this up is there's a lot of people in North America who have never heard of a company called Tencent. Yet it's a bigger market cap than Facebook. It's almost a trillion dollar market cap company.

Explain how you created a joint venture with them, and how it's so important to be on their platform.

Todd Bonner: Our cooperation with Tencent, which is a publishing arrangement, was largely a result of our combining a roleplaying game with a shooting game. It had been unique to the Chinese market. They saw the vision of that, and they felt that that would occupy a niche that just isn't filled. Obviously, the largest market in video games is China.

This year, I would expect \$37 billion out of maybe \$117 billion, emanating from the Chinese market, which is larger than the U.S. market.

Marin Katusa: Let's talk about the regulations that a lot of people don't understand. There are so many of these start-up games, thinking that they'll bring their game to China. But let's talk about the restrictions on the foreigners coming in, unless you have a local partner.

Todd Bonner: Our games are 100% made in China. Foreign games can certainly come in, under a publishing arrangement with a local Chinese partner, and these Chinese partners can be very selective. Obviously, it takes a lot of money to market a video game, so they are going to be selective.

I guess Tencent can choose any game in the world. They're the most powerful company. They look at, I think, every single major product. Choosing, obviously, endorsement by Tencent is a significant factor. We're lucky to have our game. We actually designed our game in conjunction with Tencent, over the last six years.

Marin Katusa: Let's talk about Fortnite, today. Every kid is doing the dances. Professional athletes are doing the dances in the end zone. Professional athletes are getting banned from playing it on the road, because it's inhibiting their performance, because they're so addicted to this game.

Yet there are companies listed in the New York Stock Exchange and the Nasdaq. One is Funko, who creates the little Happy Meal packages. It's gone from \$5 to almost \$30, based off of Fortnite getting now the commercialization.

So, what was your relationship with Fortnite?

Todd Bonner: I can't really discuss that, but we had contributed somewhat, to Fortnite art. We generally outsource. We were originally called Epic Games China. Our company started with a joint venture with Epic.

Marin Katusa: And Tencent owns about 40% of Epic?

Todd Bonner: Correct. Around 48% of Epic, nearly control, but just underneath the 51% level. They work very closely with Epic, as well. Fortnite was actually started about six, seven years ago. It was a player versus environment game, cooperative play against zombies. You build forts, to fortify yourself against the zombies, and your squad against the zombies.

Actually, it didn't do that well originally, for all of those years. Then, there was a tweak. They turned into a PVP game.

Marin Katusa: Which stands for what?

Todd Bonner: Player versus player, players fighting each other. Very popular in China and southeast Asia. That made every difference. Suddenly, Fortnite became a major product.

I thought Fortnite potentially could be a write-off, at one point.

Marin Katusa: So, behind the scenes, you worked on the collaboration of the art side of things, and you have a relationship with Epic, obviously. So now, what do you expect, moving forward in this sector? This is creating more cash flow than the whole mining sector, when you look at just a few select games.

Has it reached saturation, or are we just at the beginning of it? Where are we, in the bull market, in these [inaudible 07:31]?

Todd Bonner: That's interesting. I mean, if you look back at the history of video games, the initial platforms, the ones that Pong were played on, then new platforms. PC comes, and that becomes a new platform for gaming. Then, games were generally single player games.

Then, connectivity occurs, which effectively, combined with the PC, creates a whole new effective platform. As connectivity expands, video games just continue to expand; demographically, geographically.

The gaming sector always gets catalyzed by some platform shift. Meanwhile, the games get bigger and bigger. With the increased power of CPUs, the brains of computers, and GPUs, the graphical processing units, video games have to become necessarily much bigger, on average.

So, a top-end game, let's say in the year 2000, would cost maybe \$2-\$5 million U.S. to make. Now, it's \$500 million.

Marin Katusa: Let's talk about your track record. Your first game cost just under \$4 million to produce. How long did it take to make?

Todd Bonner: We took three years to make our first game. It started in 2009. We published it around 2012.

Marin Katusa: And the revenue on that was?

Todd Bonner: We made \$60 million in revenue, on that product.

Marin Katusa: Off of one game, and it's still making money today, the ultimate royalty.

Todd Bonner: Off of one game. Today, it's still making money. As a matter of fact, the next sequel is coming out early next year.

Marin Katusa: Let's talk about now, your next product, that you think is going to be a challenger to Fortnite.

Todd Bonner: We have effectively two video games. One is a PVE game, much like Fortnite's original game. That game is meant to supplant some other games in the Chinese market. Tencent plans to vector, assuming we hit certain retention rates which we're getting close to, will vector users from an aging product, into that game.

The aging product made approximately half a billion dollars a year, and we get a certain percentage, about a 25% revenue split, with the games. So, that's one game. That game is cooperative play against computer-generated monsters – PVE, player versus environment.

The next game that we're making is a PVP game, much like the current Fortnite that's so successful. That game is obviously player versus player. We're doing it in a science fiction setting, unlike Fortnite, so the range of weapons that we can -.

Marin Katusa: Unlimited.

Todd Bonner: It's unlimited.

Marin Katusa: The amount of microtransactions could be much larger, in your universe.

Todd Bonner: Yes, that's the plan. And I think, also, the environments can be quite different, quite creative. Especially as we expand the IP into outer space, other planets. Other gravities, even, we're looking at.

Marin Katusa: This is starting to get so large, where people haven't clued in that a company like Amazon, for example, spent \$1 billion in buying Twitch, so that now they can get all of the data on what people are watching.

Again, Twitch is the streaming channel that has more people than CNN, MSNBC, Fox. And soon, they expect it to have more people watching it on Twitch than all of those combined. You've got Google in there with YouTube, watching the games.

So, with all of the data, and Tencent having all of this data that people want, talk about the financial aspects, where you see this going; how they can optimize their purchases.

Todd Bonner: Well, it's interesting. As you spoke about earlier, the original model was DLC, downloadable content. And it's largely moved to what we call "free to play" games, which really are not free to play. Obviously, you're paying for items, and users end up paying much more per month than they would if they had downloaded the content in the first place. They play, by the way, like 100 minutes a day on average, in our case.

The model, I believe – this is my personal view – will move to an advertising model. An unobtrusive advertising model, a model where advertising is embedded in the game in a way that doesn't interfere at all with the game play. There's been a lot of resistance among developers, to go in this direction.

We have those technologies, by the way. We're building that model.

Marin Katusa: But it's no different than the internet today.

Todd Bonner: It's no different than the internet today. It's similar to ad placements in movies. I saw *The Expanse*, which is a TV series in space, and I saw a FedEx sign on one of the space containers. It's sort of like that, except we're doing it in a way that's more interactive. You would interact with the advertisements.

I'll give you an example. In *PlayerUnknown Battlegrounds*, which was at one point in time, before *Fortnite*, the most popular shooting game in North America recently, and certainly the most popular game on Steam probably, today. There's a little can, and it just says "Health Drink" on it. I estimate that that can is drunk 400 million times per day. But there's no branding on it.

Marin Katusa: There will be, soon.

Todd Bonner: Imagine putting branding on it. Someone will do it, and we're certainly going to.

Marin Katusa: What about all of the derivative markets? You see like *Turtle Beach* came out with their headphones, and the stock went from 25 cents to well over \$10, because you've got these gurus, guys like *Ninja*, who get paid more than any President in the history of America, to show up and just hang out for a day. A million dollars a day, to hang out!

You look at this, and now he's bigger than any superstar. He's the next Michael Jordan. He's on the front page of *ESPN Magazine*. There's this whole new paradigm shift. But yet, when you look at the professional athletes, it used to be "Be a big linebacker to get a University scholarship." They're actually looking for e-athletes, now.

But what about the derivative markets, such as Hollywood, and the licensing rights to movies? How does that work, in this sector?

Todd Bonner: There's never really been – there's been good crossovers from video games into movies, but not good crossovers from movies into video games. So I think, and I've heard of many efforts – I've even been invited to work on, I won't name them, but various movies. Because we have very low – our costs are about one-tenth the American costs.

Marin Katusa: Explain why. What did you do different than the North American game developers?

Todd Bonner: You mean in the cost structure?

Marin Katusa: Correct.

Todd Bonner: I think we took the risk. We endeavored to make the highest quality game, a western-standard game, like a Gears of War-standard game. We helped on some various AAA outsourcing for Epic, in China, which was considered impossible maybe ten years ago. But actually, we were able to do that within four or five months.

Marin Katusa: Talk about the difference, the cost structure difference, now that it's established – the advantage you have.

Todd Bonner: I could say that for a very high quality studio, the fully-loaded costs, let's say North America, California for example, would be about \$20,000 to \$30,000 U.S. dollars per month, for a high-end developer.

Marin Katusa: So, you spent a little over \$60 million for your second game. What would that equivalent cost, in the U.S.?

Todd Bonner: It would at least be three to ten times more, depending on how long the development cycle is, and what standard game it is. Three to ten times.

Marin Katusa: One thing I really want to stress to anyone watching this is it doesn't matter what sector you're in. Whether you're in mining or oil or pharmaceuticals, you always want to be in the lowest-cost quartile of cost production. At the end of the day, it comes to dollars and cents.

What you've structured here is the same quality of product, but yet three to ten times cheaper, essentially.

Todd Bonner: And it gives us, instead of making a game costing – the largest video games have gone from \$5 million in the year 2000, to \$500 million today. As we said earlier, we can make for \$60 million, effectively a \$500 million game.

Marin Katusa: Let's talk about the actual gold mine that you can actually have with these games. Fortnite's payback was, when it went from PVP, what do you think the payback was?

Todd Bonner: It can't be calculated. I would say – I'm just guessing, but they spent certainly less than \$200 million on Fortnite. Probably less than \$100 million, when it first launched in PVP. I don't know the numbers.

Marin Katusa: You're looking at less than two months' payback.

Todd Bonner: Our outsourcing certainly would. I would guess it would pay back – I'm guessing it's making something like \$3 to \$4 billion this year. Of course, they have to do a split with their publishers, but they're self-publishing in most of the world.

Marin Katusa: Let's talk about that structure. You're launching in China, with Tencent. But does that mean that Tencent gets a piece of the action in Europe and North America, and around the world?

Todd Bonner: The way it works, and I think with the exception of Tencent, the monolithic company, is that developers are starting to – when digital distribution shifted, I think it's shifting the power into the developers' hands, and into creators' hands. This is the first time this has ever happened in the industry's history.

So, we're price-givers, not price-takers anymore, so we don't have to deal with these publishers. Dealing with a publisher is impossible. I mean, it's like a highly negotiated private equity deal. You can imagine. The publishers had all of the sway and all of the leverage in the negotiation.

It isn't the case so much, anymore. I hear more and more complaints from publishers, "We can't find good product. It's too expensive." Developers, because of digital distribution, basically can pretty much write their ticket.

We're doing ancillary businesses. We are trying to, for instance, change the way video games are financed. We're going to be soon issuing a game futures product, where the developers can show early art concepts in the design documents, and possibly get financed through our organization.

Marin Katusa: It's almost like a pilot.

Todd Bonner: We're going to offer in-game advertising platforms, and even a pre-buy, perhaps, of the advertising, through clients that we will line up for them, brands that we'll line up for them, or advertising agencies. We've developed that platform.

Marin Katusa: When do you see this becoming mainstream, where it's on the front page of the newspaper? Do you see this five years out? Or do you think we're on the cusp of even the big money managers; the Goldman Sachs', the KKR's? When do they get involved in it? Or have they just started?

Todd Bonner: I think, obviously they're investing companies like Activision and Tencent. They've gotten involved in these things.

Generally speaking, I think they will be a little bit late. I think what will innovate this market – I know it's a dirty word – is sort of the crypto buyers. The guys that buy like crypto currency, I think they will be the first guys that finance these types of products. They'll take the more speculative risks.

I'll give you an example. There's a game called Star Citizen. That game sold – I could get the number a little bit wrong, but not very wrong – about \$230 million worth of rocket ships. And the game is not built yet. It's in prototype phase or beta phase right now. It's not fully commercially launched.

Imagine if that rocket ship had a royalty attached to it. So, you're a gamer. You can buy the rocket ship, and you can buy a right to a potential future income stream from the rocket ship. I think that will be the next -.

Marin Katusa: It's difficult for people who invest in the gold or silver, the hard assets, the tangible assets that you can drop on your foot, thinking "I can have a royalty on a gold mine, or I can do a stream on a copper porphyry, and get the silver for free." But to understand a royalty in the digital space, even though it's no different, it's going to be so hard for the traditional investor to get.

So, I understand what you're getting at with the crypto, because they think that way. But what about from Axion investor's standpoint? What are your internal projections, for the launch of your game?

Todd Bonner: We can't speak in forward terms, because we are public. But I think it's clear that games like Negan, which makes half a billion a year for six years.

Marin Katusa: But Tencent is no dummy. They've already done all of their due diligence, and they understand that they're not going to waste their users, their subscriber base, with something that they're not confident is going to work.

Todd Bonner: Tencent is able to take games that perhaps I would not even consider investing in, because I would not think the quality is there. I was talking to one of my colleagues, Wil Mozell, earlier, and we would not invest in some of the games, perhaps, that they would have picked up.

But they manage to moneyball them, or tune them to market. It's a long process, sometimes one or two years. But they're able. They have the magic. That's obviously big data analysis, and a lot of trial and error. And you need to keep your costs down.

Marin Katusa: So, someone who likes to make a big score, let's not make forward projections. But let's ask Todd for his internal – what type of revenue are you looking at, that you would be disappointed with, because you think it's going to be a lot higher? Give me a baseline. Not forward projections, but what you think.

Todd Bonner: We alluded earlier to our 2011 product. We put \$3.6 million in, and made only \$60 million so far. I consider that a failure. We screwed up. We made the frame rate too high.

Marin Katusa: In the mining world, that's unheard of. That's a huge success.

Todd Bonner: And our failure was we did not project the state of Chinese computers, at the end of the development cycle. We thought Chinese computers would be, the average PC spec would be higher. So, the frame rates, when they played our game, was too low.

Marin Katusa: What about now, when you see the iPhone X, and now they have gaming phones coming out, just specific gaming phones? Are you going to make them cheap enough that a gamer will have his phone for real people, then his gaming phone? How do you tap into that market?

Todd Bonner: The phone in your pocket, that I sell you, is as powerful as an Xbox3. And if it had the proper interface, the proper UI, and the keyboard – if you had some sort of controller linked to it, I think it's an Xbox. If you had a headset, a VR headset, you have even a more immersive experience with a telephone, with a mobile phone.

Marin Katusa: Do you see Apple getting in, by buying the traditional players, like Nintendo? What are the moves that you see, from a big picture?

Todd Bonner: The big picture is a major change in the monetization model. I alluded to it, with the in-game advertising. If it's done properly, if someone gets it right. We certainly intend to try. That's the biggest change I see in the industry. I see constant expansion.

The next big change is VR. Everybody talks about it. It's a trite word now. The difference between playing even our own video games, with a 3D screen in front of you - just with a computer screen, a 3D video game – and putting a headset on, and being immersed in the world, is night and day. It's shocking.

Marin Katusa: So, what is Axion doing? Because you're on the cutting edge of game development. What is Axion, and what are you doing, to be on top of that? I think VR is going to be the next level. What are you doing to tap into that?

Todd Bonner: We can easily make translator games in the VR, with the technologies that we use. That's trivial, actually, to do that. The thing we have to wait for is the hardware to catch up. The hardware has to be well-distributed.

Marin Katusa: How far away are we from that?

Todd Bonner: One year, two years, something like this. It won't be long.

Marin Katusa: It sounds to me like when you study the history of Pixar, for my audience, could you maybe make a connection, that you're the Pixar of video games?

Todd Bonner: I think we generally use technologies, provided middle-ware that we modify. And we can certainly reach any of those standards, and we can do it for one tenth Pixar's costs. Maybe one eighth, something like that. That's trivial for us. We've been able to do that for years.

Chinese standards are lower. The PC specs are a little bit lower right now. But I see Chinese PC specs closing the gap very soon.

Marin Katusa: Todd, you have one of the most fascinating histories I've ever worked with. And I've worked with a lot of billionaires in the sector that I'm known for, in the resource sector. But you have worked with some of the wealthiest people in Asia.

What can you say about the big Asian investors? Where are they at, when it comes to this sector? Because a lot of the North Americans that I've been talking to are going "What are you talking about?", because it's so new to them. What about the Asian billionaires?

Todd Bonner: When I first started looking, buying video game companies maybe 15 years ago, 18 years ago, companies that have become very large at this point, you know, made \$60 billion, there was no interest in buying these companies. It was very frustrating, actually.

Even the institutional investors in the U.S., and I talked to some famous names in England you would know – a lot of names you would know – there was no interest in it. But I see, for instance, we did a deal with CP Group. This is a very large Southeast Asian group, the largest. They obviously understand this very well.

Marin Katusa: They're there as a keystone investor.

Todd Bonner: Yeah. I think people understand it. Fortnite certainly catalyzes their understanding. I think they're playing Fortnite, right?

Marin Katusa: When you see the Halloween costume, it's now become what my generation understands as Mario and Luigi, or Donkey Kong. It's got that true icon status. And this is on a cash flow level that is two or three orders of magnitude higher than anything Nintendo ever produced.

Todd Bonner: In the example of some of our partners, that were large companies, they realized that distribution and buying video games is not as valuable as owning IP. I think we see that transition among large Asian investors.

Marin Katusa: So, will Axion jump into the royalty streaming digital world? Is that potentially something that an investor can look at?

Todd Bonner: We don't have the capacity to build that platform yet. We're very focused on the advertising. We think that that is low-hanging fruit. We think it's done very poorly. And we happen to have a lot of video games; 3,000 man-years of forward-looking portfolio.

So, we're going to try to launch all of these games, and we're infusing in-game advertising into everything. Also, crypto collectibles. For example, if you're a company that makes crypto collectibles, you may have sold those successfully, millions of dollars. You have to put them in the video games eventually. If you don't have the ability to make video games, what do you do?

For instance, if I make a dragon game, for example, I'll sell the dragon egg. Then, the dragon egg will be some form of blockchain-tokenized item. Eventually, that dragon will hatch, and you can breed dragons, and you'll put them into our video game. That's an example.

We'll have advertising opportunities in the game. The gamers will not need to pay for this anymore. The dragon will have a game royalty associated with it. So, the dragon egg will have a future participation in the revenue stream of the game.

I think, in my personal view, gamers will love this. I think gamers will really appreciate that opportunity.

Marin Katusa: This was fascinating, Todd. Thank you so much for making the time to do this.

Todd Bonner: Thank you, Marin. I appreciate it.