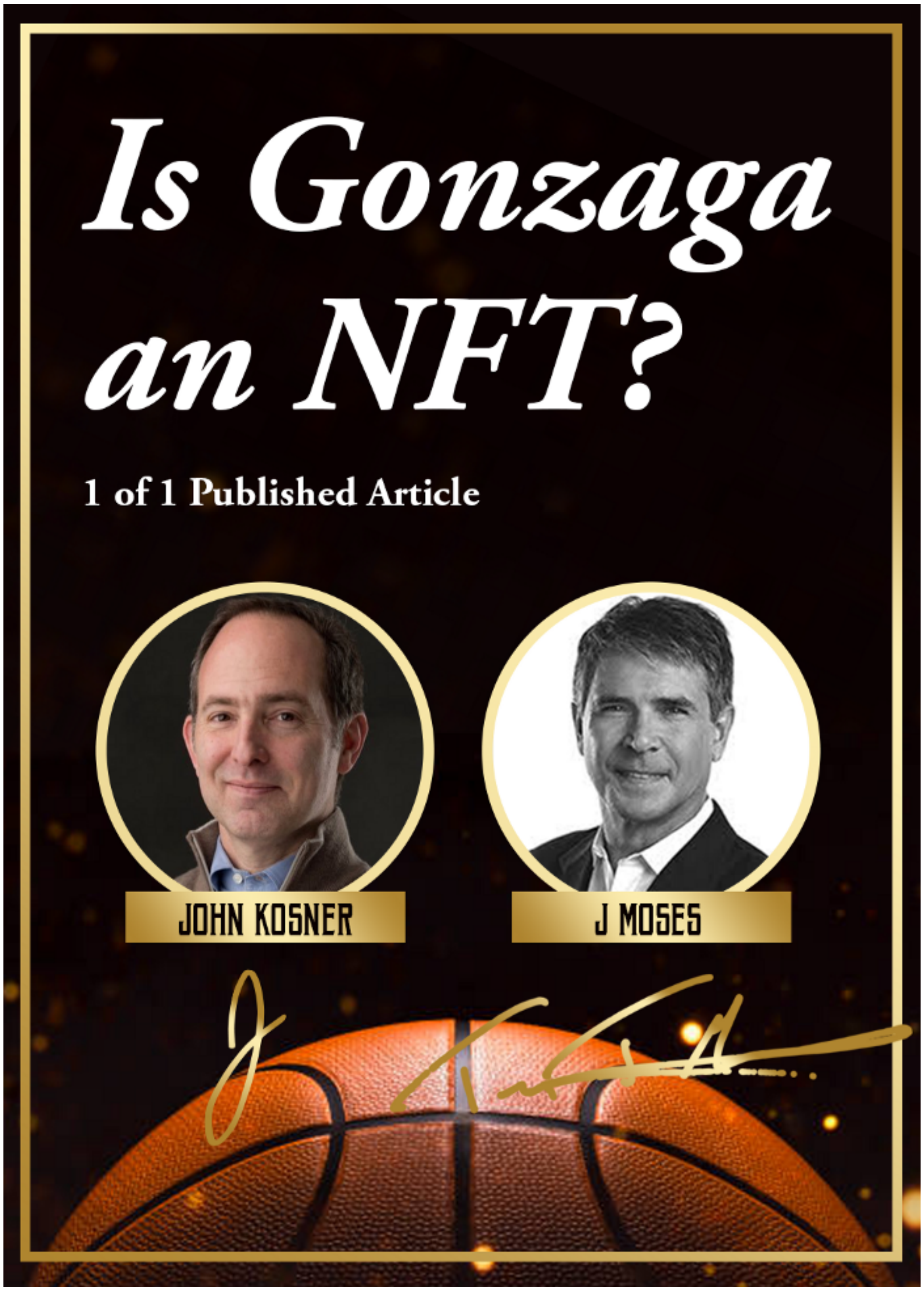

Is Gonzaga an NFT?

By John Kosner & J Moses

Is Gonzaga an NFT?

Not yet, but soon.

Gonzaga is the undefeated #1 seed in men's college basketball as tonight millions of us fill out our March Madness brackets. A year from now, we will probably use blockchain technology for our brackets — opening up prizes, experiences and recognition not possible today; the winning one would become March 13, 2022's biggest "NFT."

Perhaps you live under a rock … or your eyes glaze over when confronted with the latest complicated and speculative idea. *What is an NFT and what is all the excitement about*?

An NFT is a "non-fungible token." As Mason Nystrom and Ty Young of Messari write in their excellent explainer, "NFT's are a [digital] file format that transfers data and value on a blockchain network like Ethereum … an NFT is simply a token (or piece of information) that is unique." An NFT is neither divisible nor interchangeable — you can't exchange it 1–1 like you can Bitcoin, today's leading cryptocurrency. Today, among other things, you can buy NFTs that represent art work (Yes, a Beeple went for $69 million at Christie's this week) and in sports, NBA video highlights through Dapper Labs' "NBA Top Shot" app (where one collector's $175K investment is now worth $20 million).

Virtual goods are coming to sports — *finally*.

This is the third in a series of essays about why gaming is ascendant in culture, especially among the young, and what those of us in Sports, Media, Investment … *all of us in business* … can learn from games. In our second installment, published on Super Bowl Sunday, Feb. 7, 2021, we wrote that games naturally promote and benefit from super-engaged communities. A direct result: **a virtual goods business in games worth *$79B* annually.** The business of those "goods" — including "skins" to dress up and "powers" to enhance your in-game persona — is actually growing 8% a year. *But Sports gets about $0 from virtual goods*.

That is, until NFTs and blockchain — the most important new trend in sports fandom and, intriguingly, a potential threat to the games business which invented the virtual goods bonanza.

You can buy an NFT and own it forever and monetize it however and whenever you want. That is possible because of blockchain — the new internet that allows everything to be catalogued. David Pakman, a partner with VC firm Venrock and one of the earliest investors in Dapper Labs, notes that NBA Top Shot [here is an example owned by John's friend Ryan] is "a digital collectible. It has a provenance. It has a set of rules encoded in software behind it. It is written on a public blockchain. It's fully verifiable. It runs across hundreds or thousands of computers around the internet. On a network that anyone can join." Because NFTs can be cataloged, they can be traced. In there is the revolution.

Today, there are two types of virtual goods:

1. Powers & Skins

2. Collectibles

1. Powers & Skins. Virtual goods in games (the $79B business referenced above) is *fully-integrated*. Think: Fortnite. You can only use virtual goods in the game you're playing. They give you an edge in the game. Favored by early adopters and super users, they power the super communities supporting games.

This industry is pre-blockchain and there are downsides. Virtual goods in games are *virtual* and you only really "own" them while you're engaged in the individual game. They are not interchangeable between games. Control of these game virtual goods rests with the game's publisher (like Epic Games) which means, per Pakman that you have "to trust them not to print more all of a sudden like Fortnite does all the time to ruin your scarce assets."

With the explosion of NBA Top Shot, one might expect that any video game based upon league name and marks — such as EA's Madden NFL or FIFA games — would begin to include NFTs.

That is not likely anytime soon.

A version of game virtual goods ("loot boxes") is the subject of a class action suit against Apple in California, arguing that these are "gambling" and potentially "predatory practices enticing consumers, including children." To counter any gambling taint, game companies offering virtual goods take the following legal position currently: virtual goods can be consumed within the game only and nothing of value can be transferred or traded out of the game.

Worth noting also that NFTs are the nemesis of the game model because the player, not the publisher, actually owns them and thus they have a value outside of the game's vertical walled garden. The 80 (or rather, 79)/2 rule applies here. Two percent of the super engaged gamers create the 79B virtual games marketplace. We expect similar dynamics for sports.

2. Collectibles. Sports collectibles hasn't really changed its physical roots since we were kids. It's still a robust business. But prior to the blockchain, there was no way to enforce digital scarcity.

For those of us over 40, remember when you saved up your money as a kid to buy Topps trading cards? Put them in your bike spokes or traded them with your friends? Then you put them in a cigar box and there they sat until you moved and your parents tossed them out? In J's case, heartbreakingly, movers lost his childhood memories box. In that box was a Stan Musial baseball card in mint condition. John would nag his father to go to New York Yankees' Bat Day so he could get a Reggie Jackson bat. The latter was the subject of great attention for 48 hours, then went into a closet and oblivion.

The new world of NFTs solves all of these problems and creates monumental new opportunities. Yes, NFTs are virtual and you may think: who wants a virtual card, bat, highlight or ticket? But let us explain why you might. Remember, you were once reluctant to purchase a movie online when you could buy a physical jewel box version instead. Collectibles are morphing from physical to digital because of the scarcity enabled by NFTs on the blockchain. Your possession of the NFT with its digital certificate of authenticity means movers can't lose it, you can't spill water on it, etc. The new owner of the New York Mets' Steve Cohen recently purchased Collectors Universe. How long until the Mets roll out a game ticket that's an NFT and rewards their long-suffering fans? Scan in the QR code at the gate and, after you attend 25 games, you get a tour of the clubhouse. Fifty and perhaps you can meet the Owner himself!

And then there is the real game-changer: the subject of the collectible and its owner — say, the Honus Wagner estate or Zion Williamson *and you* — can now capture future value together.

In the past, professional athletes would get paid for their rights to be represented in a trading card, typically through their league's joint-player license with a third party like Topps or Upper Deck. That's it. When their card value escalated, the players got bupkis. But now, the players don't just participate in the future value of their virtual good, they have incentive to do so. Forever.

As in games, this is where super-engaged communities (the subject of our last column) come in. There is a connection between the original Bitcoin subreddits of the previous decade, wallstreetbets and the 2021 stock market "short squeeze" and where NFTs are headed. Passionate communities will drive adoption and value of NFTs over time as individual investors stand to gain by connection to the creator. It is one thing to subscribe to a notable's YouTube account, another to be financially tied.

This is a crucial point as we look at the future of sports and the triple whammy of (1) the current decline of key revenue sources like pay TV through cord cutting, (2) the lessening interest of young audiences towards watching live games and sports in general and (3) escalating player salaries. NBA Commissioner Adam Silver has made the point that 99% of a team's fans will never attend a game. Now through digital collectibles and unique products like Fan Tokens (pioneered by Socios, a European blockchain startup, now serving some of the top European football clubs like FC Barcelona, Juventus and Paris Saint Germain), sports can offer an interactive experience with previously impossible access to young fans globally. Today, fans of certain teams can choose the music that their players enter to and the shoelaces they wear. In time, that input will expand. And, sports rights become *more valuable* to digital players!

Imagine if the bat that John forgot about included a limited-edition signature from the Yankee Hall of Famer? If it constantly updated with new video highlights and metadata? [Nike is already doing this with NBA replica uniforms]. If John could show it to friends on his phone and potentially sell shares of it through collectible marketplaces like Rally Road? If, at the time, it could have facilitated some actual connection to Reggie Jackson?

Typically, collective bargaining agreements are among the most grueling processes and often feel like a zero-sum game for leagues and their players. In the new world, however, the right collective bargaining agreement is the key to unlocking tremendous value for both. Ultimately, those 100 "official" Zion dunk highlights on NBA Top Shot are most valuable with both the imprimatur of the league and its IP (the highlights, the marks, the brand) and Zion's participation himself. How long before a blockbuster deal like Dak Prescott's 4-year, $160M contract with the Dallas Cowboys includes a club buyout of the player's NFT rights?

Of course, it will be a long and pothole-filled road getting from here to NFT nirvana. The user experience in acquiring many NFTs remains hopelessly difficult for normal people. It's not a coincidence that Dapper

Labs, creator of NBA Top Shot, *is actually a games company*. If you use Top Shot, there is no mention of NFTs, blockchain or crypto wallets and you can use your credit card. Dapper is abstracting the experience just as Steve Jobs and Apple did with the complications of MP3s and digital music players when they launched the world-beating iPods 20 years ago. Additionally, some of the blockchains being utilized today will not succeed. For that and other reasons, the legal agreements here need work. Today's speculative boom is certainly tomorrow's bust. The energy, ecological, social-political, money-laundering and IP control issues now being raised are complicated to say the least.

Nonetheless, in time, we believe these problems will all be solved or dealt with. NFTs are a breakthrough for sports — not just economically but because of the joy they will bring.

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Originally, we would fill our NCAA brackets by pen and paper. Then they moved online — and the faraway schools we selected, such as Gonzaga, were pre-NFT's (digital assets that were *ours*). We may be a ways off from sports' virtual goods having powers — like a Gonzaga-killer that fans of the other 67 NCAA Tournament schools would be buying now — as that product would require a vertically-integrated engine similar to what we see in games. But that's coming too.

Meanwhile … look out!

And, since you asked, ***yes***, this column is also available as an NFT here: ***JohnKosner.Kred***

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