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Augur ($REP) Analysis & Valuation

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An executive summary is presented below. Download our complete 13 page analysis, including full valuation and price targets:

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Executive Summary

Augur is a decentralized prediction market built on top of the Ethereum blockchain. Its native token, REP, is a utility token that allows REP holders to perform work for the Augur network in exchange for a percentage of the network fees. We firmly believe that blockchains will be the foundation to fulfill the long-recognized vision of prediction markets. Augur is the most advanced and promising prediction market.

The Promise Of Prediction Markets

Prediction markets have been of interest in both the financial and academic sector for decades. Several different studies (Link 1, Link 2, Link 3) have demonstrated the superiority of prediction markets over traditional means of event

forecasting. By combining the concept of the "wisdom of the crowd" with a financial incentive that encourages accurate predictions and discourages false forecasting or signaling, prediction markets are able to elicit more accurate information about future events. The long-term implications are far-reaching. Global, decentralized prediction markets could not only offer society's best information about the likelihood of any future event, but also the ability for nearly anyone to participate in these financial markets. This widened pool of global brain power increases the accuracy of predictions, creating a self-fulfilling virtuous cycle.

While current prediction markets mostly function as betting platforms for political and sporting events, we envision platforms like Augur enabling entirely new possibilities. For example, a person could create a market to predict the probability of a hurricane striking a certain area within a given time frame. This information could be used to determine prices on home insurance premiums in that area. Furthermore, people living in that area could then use this information to hedge against that risk. Not only do prediction markets offer superior information about the future, but they also allow users to leverage this information to hedge *against* predicted outcomes. We believe that these are just a few of the entirely new possibilities that decentralized prediction markets will enable. We predict that Augur will greatly surpass the current market size of existing prediction markets, as the creation of a decentralized prediction market will itself expand the total addressable market, just as Uber expanded the taxi market and digital cameras expanded the photography market.

History of Prediction Markets

Many have attempted to create prediction markets using traditional centralized database technologies. Historically, prediction markets have been heavily regulated and forced to operate under the laws of their specific jurisdictions. Barriers to adoption have included strict capital controls and regulations, outright exclusion based on geography, high fees, and counterparty risk. Additionally, incumbents such as casinos have lobbied governments to maintain their dominant market position for certain betting sectors.

These barriers to entry severely limited the liquidity pool and therefore caused these markets to be inefficient. Furthermore, because of their association with gambling, prediction markets have been a prime target of government regulators. Several of the most prominent prediction markets have been shut down entirely, sometimes by governments outside of their respective jurisdictions.

Augur Protocol Design

In order for a prediction market to succeed, it must be highly liquid and have low barriers to entry. For this reason, the blockchain presents the most viable backbone for the construction of this type of platform. By eliminating the need for a central authority to govern the prediction market, blockchain-based prediction markets avoid the risk of regulatory shut-down that plagued predecessors. Furthermore, the availability of mainstream cryptoassets such as Bitcoin and Ethereum (as opposed to a proprietary currency) to denominate markets materially lowers the barriers to entry and allows for global participation. This, in turn, increases the accuracy of predictions by allowing nearly anyone anywhere with superior information to leverage that information in a profitable way. Finally, by eliminating centralized overhead costs, blockchain-based prediction markets can offer trading fees much lower than centralized alternatives. PredictIt, for example, charges 10% fees on all profits, while Betfair rates are variable but range between 3-7% or more. Most estimates suggest that Augur network fees will be on the order of 1%. Because of overhead and regulatory costs, it's unlikely that centralized prediction markets can offer competitive rates.

The greatest challenge for decentralized prediction markets is to implement a system by which event outcomes can be resolved and agreed upon. We believe that Augur is the best-designed of these solutions. Stox requires markets to be denominated in its (inherently volatile) native token, which will impede adoption. Gnosis has a solid team in place, but the platform employs an overly-complex token mechanism and dispute resolution process that relies on untested and tenuous cryptoeconomic assumptions. Furthermore, >90% of GNO tokens are held by the development team and foundation, and the release schedule is unknown. This will likely create downward price pressure on GNO tokens.

There is a risk that the use of centralized data sources (such as Oraclize or RealityKeys) for resolving prediction markets could negate the need for reporters on a network such as Augur. The Augur network charges fees regardless of whether a market is resolved by using an automated data source or by utilizing the decentralized oracle feature of the network. This is structurally more expensive than potential competitors which may emerge in the future. However, the REP system functions like an insurance policy against compromised data feeds and also allows for dispute resolution. We believe that the value provided by this backstop will outweigh its associated costs.

Augur's token structure incentives REP holders to report on event outcomes. There is a direct cash-flow incentive built into REP ownership, since active REP reporters earn fees for their work. Fees are paid in whichever currency the market is denominated, including ETH, BTC, and ERC20 tokens. The Augur development team, which we believe to be one of the strongest in the Ethereum ecosystem, has expressed its intent to continue to experiment with fee structures that will strike the right balance between predictors, market makers, and REP holders.

Conclusion

We believe decentralized prediction markets will reshape global finance markets and democratize finance in many respects. Augur presents the most compelling opportunity in the prediction market space. At current valuations, we are very bullish on REP tokens and believe that REP will outperform the cryptoasset market over the next 1-2 years.

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