diffusetap
Virtual Event Series

How to Price NFTs

Guest Speaker:

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Founder & CEO
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Hosts:

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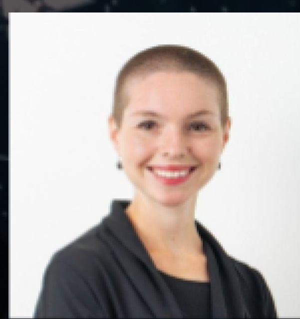

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Diffuse

DiffuseTap: How to Price NFTs

Last time on DiffuseTap, Layne Nadeau, Founder and CEO of NVAL, talked to us about why data metrics in traditional finance don't work with NFTs, how previous market action is mostly driving the pricing for NFTs, and why NFTs are rarely mispriced on the market.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)… straight from your armchair like a boss.

Meet the Speaker

LAYNE NADEAU is a tech and finance industry veteran with over 19 years of enterprise software experience across multiple industries including institutional finance, retail banking, and digital assets. He is the Founder and CEO of NVAL, a digital asset analytics company that focuses on creating NFT market data and analytics technology to enable the NFT ecosystem.

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KENNY ESTES: Layne, would you please tell the folks a little bit about your background and what you're up to over in NVAL?

LAYNE NADEAU: Sure. Hi, everyone. Many of you will have heard this intro before, so enjoy it again. I have a computer science background. I spent about two decades delivering enterprise software projects, most of that while running my own consulting business. And for about the last five or so years, I have been in the world of institutional finance and large private banks.

I really got a good front row seat to the plumbing of finance. I was working with a private bank that was trying to custody and work with digital assets, which really got me looking at that technology stack. Then I just fell in love with it. I went down the rabbit hole, as I'm sure most of you have at some point, and recognized all the opportunities that this tech enables.

And also, it was very nascent. There was just so much that hadn't been built yet. So, I started building. We built a company that focuses on market valuations particularly of illiquids or NFTs because that's really a problem space that we have so much to explore. That's me.

AYLA KREMB: I'll start tossing questions to you. The first one is around the NFT community. Maybe you could share a little bit about what's happened with NFTs. It was once all the rage. What happened now? Where are we at in the NFT space?

LAYNE: Sure. We followed DeFi summer with the NFT rally, and everything was a speculative push for the most part. Things used to be based on art and people liked them as collectibles. Then they realized that there's money to be made. And so, this entire speculative push went through that. But it blew up last May, give or take.

We've seen a retrace all the way back down to what some would argue is probably the value driven pricing or price point. There has been a lot of activity. There is still obviously a lot of volume, although not by the standards that were there before. Last time I looked, they're still doing something in the order of $70 million a day in transactions in the NFT space.

It's not very big by global standards, crypto standards, or traditional finance standards, but they're definitely still around. One of the things I think that's worth remembering is, and I love bringing this up when talking about the digital asset context, that Warren Buffett quote "Value is what you get. Price is what you pay."

It's worth remembering the difference between those two in this context, because a lot of retail doesn't really think along those lines. This is a very heavily retail-driven asset class or asset group. There are a lot of people out there that have experimented with discounted cash flow and other kinds of future value calculations to bring some value investing metrics into the space.

But unfortunately, it's much more momentum driven. Those haven't really bared out as anything that's realistic to work with. And right now, we are seeing that market retrace back to where I think value is primarily what's driving it, with the exception of a few different asset classes.

KENNY: So we're talking about the foundation and talking about value versus price. That totally makes sense. People are trying to do DCF on it. But what do the actual cash flows look like? What's driving the underlying value here in terms of where value is being created to the larger world?

LAYNE: Great question to unpack with. I like to say that NFTs aren't an asset class. They are no more of an asset class than what a deed to a house is. They are really just the ownership record. And so, what that asset class is really what defines the value. That can be anything. That can be real world assets. That can be digital art. That can be a membership pass to an exclusive club. It can be a combination of those, like Bored Ape Yacht Club. And so, the value becomes very subjective.

Just like regular value investing, the markets don't always agree with what you assess as the value. From a DCF standpoint, or from any of those traditional valuation metrics, we can apply them because a lot of these do have an annuity or some other sort of cash flow component to them. They're almost exclusively driven by future returns on the sale of that item, *not* the intrinsic value that you would get by being part of a club, for example.

AYLA: What do you think are some of the key drivers right now with certain types of NFTs? Is it still the collector item that is driving the value? Does it now have more of a utility concept to it, where you could say “hey, these entities could be in a game, and therefore there is value”? How do people think about adding value to an NFT now?

LAYNE: After the market blew up, what we've seen is a retracement to a bit of a polarization. In a blow up, when everything's really, really high, there's so much speculation that really just muddies the market. There's no way to trace where the real value from the market perspective is being doled out.

What we see now that things have settled down a bit is this polarization, where some collections or some groups of assets are very heavily trading on their actual futures. If you take art for example, like CryptoPunks which is one of the originals, about 80% of their market price is driven by the features, the traits, and the art that goes along with them.

This is an example of something that people are buying and selling based on what it was created for, what that art is or was, and what they like. It’s really driving towards the actual value that you're supposed to get with this art. Conversely, on the other hand we're seeing that 98% of the market price of some other assets is just previous market action. Yuga Labs is a really good example for this, and Bored Ape Yacht Club is probably the highest example.

It has nothing to do with the art and nothing to do with the collectible, the rarity, or any of those things. That really just shows that that market is being driven and is acting almost like a liquid asset class. And with marketplaces like Blur coming online, that's really what they've done. They've tried to take illiquid assets and make them liquid because people want to speculate on them.

I'm going to follow on to another topic here that we don't need to dive into, but what this shows is a lack of derivatives. If you just want price exposure to speculate on or to hedge, you don't have to buy the actual assets. You could just take out an options call or a perpetual, or something like that.

And until those really come online in force, we're going to see some of these asset classes continue to be hyper liquid, despite them really being non-fungible. The intention or the expectation on the face of it would be that they are actually unique, and people buy them for their unique features.

KENNY: Alright. You talked about speculation and NFTs being used for that. But the flip side to what you're talking about are DCFs, which you can't really do DCF on pure speculation. That's a good segue to Chris's question. Asset-backed NFTs seem to be pretty popular in the tokenization and more real world asset NFT hybrid. What does that market look like? I've heard that there is almost no real adoption from investors. What's the state of play there?

LAYNE: Sure. So the trick to this is that we have existing markets for these types of asset classes. I see real estate and stocks. What this looks like now is the tokenization and NFTs are really unlocking a new pool of capital. It's not changing how those assets are purchased.

Although if you're purchasing with fractionalization, which is one nice feature of NFTs, or have tokens in general, then you're really in the market for price exposure as opposed to trying to take possession of the entire asset and therefore realizing the underlying value. It's certainly happening.

Those are gated pools typically, where you're KYC-ed. And therefore, that makes it easier to bring native digital asset capital into play and to use. But it doesn't necessarily change how those are bearing out. We do see a premium or a discount applied, and it depends on the circumstance. If you had a million dollar piece of real estate, for example, if it's tokenized and has access to these capital pools, we usually see a bump. We see a premium because of the ease of access for somebody who might have all their money tied up in ETH or Bitcoin, for example.

AYLA: Moving forward, if somebody was going to make it a business to find undervalued NFTs by any means, what are some of the places where they should go digging for those setups?

LAYNE: I wish I could say that you can find mispriced NFTs on the market. Unfortunately, because the majority of these markets are trading on momentum, it's very, very difficult. I think one of the other gaps in here is that the markets are not well informed enough to really be able to turn that around, for example. If you bought something that was 25% under market, to be able to turn that around in a day, a week, or a month and sell it just for market value and make that spread, the market doesn't really know.

That's part of our mission. Informed markets are efficient and are better for everyone because you don't end up with mispriced assets and poor liquidity as a result. In fact, I experienced this personally. I went to the markets, tried to buy some assets, and found that there was such a range of pricing in the offers that I walked away.

I thought, “I can't price these things. I don't know if I'm getting a good deal or wasting money on any given one. They're all different. So how would I ever choose?” The mispriced aspect is a challenge. I think the industry as a whole, or all of the market participants will be served well by having better information to work from.

That's some of the things we do at NVAL. We work primarily with brand-specific marketplaces, or niche marketplaces to really improve that user experience, where they can actually see and have confidence that they're not underselling their assets or overpaying for assets, which just adds up to a better experience.

KENNY: Okay. I'm going to try to roll up two questions into one, which is around why people don’t understand valuations better. Someone mentioned alternative pricing mechanisms and TAMI, an acronym I've never heard before. What is that? How does that work? How is that different from the price? And then also, these things are massively volatile. Is it because of information asymmetry? What's keeping the end investor from really understanding what the inherent value is?

LAYNE: Sure. I'm going to say market price instead of value for the moment. Part of it is that you can get a lot of raw data. But raw data does not answer the question of how you value any given item. Floor price is a good example. It's a horrible metric. I'll get on my soapbox for just a moment here.

It comes from commodities markets where everything is fungible, and the spread is in basis points. It's so tiny, and the industry is so hungry for any data point that's representative and that people can understand, that they started using it for NFTs and it became the default. I will be on that soapbox until we stop using floor price, just to be clear.

These other mechanisms like TAMI or averaging work in the sense of a benchmark for the category or for the class, but they don't necessarily answer the more granular question of what is any one asset worth. So if we use the analogy of real estate or any illiquids, the average home price is an interesting data point but it certainly does not help you buy or sell any one house in the market because each of them is so unique.

This is the challenge that this space faces as well. And that's something that we actually solve in real time by using machines to crunch millions of data points to come up with something usable and consumable by a human, even in markets that are moving every few minutes.

KENNY: TAMI is an acronym. Are you familiar with TAMI? Is that as an alternative to floor pricing? Or is this a new trend that I've not heard of before?

LAYNE: I don't know that acronym specifically. We weren't really heavily involved with any brackets or collection averages. We actually use median quite heavily because it's almost impossible to manipulate in any reasonable size market. If there's 10,000, Board Apes trading, for example, and there are 20 or 30 a day. We average things out over time to smooth that out so that no one actor can completely move the market. And then when you use median, you would have to saturate the market. You would have to move everything on any given day or time period.

We focus on those kinds of things. This is something that the derivatives platforms are very interested in because they don't want manipulatable market data points, especially since these markets are not as big as we might think they are at a retail level. They look very big, but from an institutional or pro trader level, they're still relatively small.

Board Apes is one of the most liquid names, and they move less than a few million dollars a day. Somebody can really come in and move stuff pretty fast if they wanted to. We've seen in DeFi and other areas that people can manipulate Oracles or data feeds with flash loans and things like that. It's certainly doable. This is why these TAMI or average metrics or median, which is what we use, are pretty important data points. I think it'll get more and more important for the derivative space.

AYLA: From a regulatory perspective, what are things looking like? Now that a lot of attention has been brought to the lending activities, the FTXs, and the security issues of the world, it feels like NFTs have taken a backseat. Is that what's happening from a regulatory perspective?

LAYNE: Yeah, and I'll actually set aside the US because I don't think they've really pushed anything forward compared to other jurisdictions, MiCA doesn't specifically call out NFTs largely because they are very new. Even by cryptocurrency standards, they're the new kid on the block.

What they did state during the MiCA legislative process was, let's take function over form. That means they're acknowledging that a token can mean anything. What matters is that this is a piece of art, and so we have to treat it accordingly from a regulatory perspective, from a tax perspective, and all of these things.

As opposed to, this could be an annuity, or this could be an asset-backed security, this could be debt positions, or this could be anything. We have regulation for all of those. So, NFTs are actually an easier one to pigeonhole into different existing buckets in the regulatory landscape. The challenge is that there are

20 different buckets there. It is an individual basis whether you're talking about a collectible or an annuity, which is clearly a security.

The IRS put out a comment or question saying "we think we might just make them all collectibles," which everybody across the industry rolled their eyes at. People were like, "you clearly don't understand that this is not any one thing. It can't really be regulated as one thing or put into one bucket."

This has been a consistent approach we've seen in various jurisdictions, which is that it's a case-by-case basis. We really have to see what you're doing with the token before we can say it falls into this category and will be regulated as such.

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