Cubic zirconium or a diamond in the rough?

Domain name valuation

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In these turbulent economic times, an increasing number of companies are endeavoring to put a price tag on their intangible assets to boost their balance sheets, prepare for a potential merger or acquisition or to help guide research and development investment decisions. Valuation of intangible assets is not something that is new or uncommon. Just do a quick Google search of "intangible asset valuation" and you will find countless pages of articles and blogs commenting on public companies who have reported the value of their intangible assets, white papers with suggested valuation methodologies and consultants at the ready to help you run the numbers. However, that feeling of relief quickly turns to despair after some further reading.

Intangible assets are often defined as something of value that cannot be physically touched, such as a brand, franchise, trademark, or patent.[1] While tangible asset valuation can look to well-documented cost, income, and/or historical market data of like assets to arrive at a fair market value determination, the very uniqueness of many intangible assets makes such an assessment little more than a "best guess" of value. Among the most unwieldy of the intangible assets to assign a value are domain names.

The domain dilemma

The dot-com boom of the late '90's put the world on notice that domain names had the potential to be a company's most valuable asset. A short, easy to remember and spell

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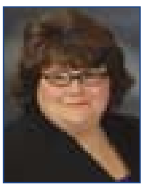

domain name, like amazon.com or ebay.com, could be both the company name and the complete directions any consumer in the world would need to find it. However, the fact that each domain name is unique (i.e., there can only be one amazon.com or one ebay.com) makes valuation challenging.

The three most widely recognized methodologies for asset valuation are cost, market and income. The cost approach seeks to determine the cost of acquiring the asset. Factors such as the costs that were incurred to build the asset in the first place, what it would cost in today's economy to build the same asset and how much it would cost to replace the asset if it were lost or destroyed today are all considered. While it would not be too difficult to gather data on the historical costs of purchasing the domain name, expenses incurred in developing and operating the domain's website, as well as legal and marketing funds expended for protection and promotion of the asset, this analysis begins to break down when trying to put a price tag on what it would cost today to rebuild or replace the domain name. On the Internet timing is everything and the variables are endless. What worked for a brand holder last week, may take more to be noticed or may not work at all this week. Furthermore, domains are not only unique in their existence, but also their context (i.e., some domains exactly match a company name, others are a specific product name and yet others are generic or are made up words that only have meaning and utility to one specific owner). Since there is no one to one comparison to estimate cost to rebuild or replace a domain, cost-based valuation quickly turns into little more than speculation.

A market valuation approach uses comparable domain name transactions as the basis of determining the value of the domain name at stake. Though no two deals are exactly alike, for this methodology to be reliable one must find a number of recent deals and compare conditions to identify distinct similarities that can be the basis of extrapolation. Conditions that are typically considered are: type of top-level domain (TLD), number of characters in the name, whether the name is a brand name or a generic name, number of owners the domain name would be relevant or useful to and language of the domain name. The big challenge with working through this type of analysis is gaining access to the data. Not all domain deals are published and some deals are not exclusively for the purchase of a domain name, but rather a purchase of a company for which the domain name may be viewed as the most valuable asset. A notable example of this situation is the domain name BUSINESS.COM. In 1999 ex-Disney executive Jake Winebaum of eCompanies Ventures shocked the world by paying $7.5 million for the domain[2], however, fast forward to July 2007 and the entire BUSINESS.COM enterprise was sold to R.H. Donnelly for $345 million[3] leaving it unclear how much of that purchase price was attributable to the domain name and how much was attributable to the remainder of business assets acquired in the deal.

Another possible approach to arrive at the value of a domain name is to utilize an income approach. This methodology attempts to determine the estimated cash flows the domain name is expected to generate for the owner over the life of a domain name. To arrive at an estimation of income, information regarding traffic, revenue and costs associated with the business are required. While access to keyword search data and pay-per-click revenue have improved, advances in technology now better enable companies to attribute a revenue number to each website visit and online marketing costs have standardised considerably, the inherent volatility of the domain name market and after-market, coupled with immaturity of the Internet environment overall still leave some grey area in this valuation method. In addition, because the income approach requires the owner to project income into the future, valuations of this type are the most susceptible to write downs as a result of impairment reviews.

Even though it can be argued that none of the valuation methodologies are perfect when it comes to putting a price tag on the worth of a domain name, most accounting and IP professionals would agree that any one of them is better than nothing at all. Domain names are too valuable an asset to be left undefined and unaccounted.

Branded v. Generic domain names

Interestingly, brand holders are not the only ones interested in arriving at an accepted method of valuing domain names, domainers are too. Domainers (people who are in the business of buying and selling domain names for a profit) are particularly interested in pinning a price tag that everyone can agree to for generic domain names. In 2007, 100 reported sales passed $100,000 , most notably PORN.COM for $9.5 million.[5] In just the first few months of 2008, amidst a limping global economy, we have already seen 29 reported sales surpass the $100,000 mark, including the new Guinness Book of World Record Holder, FUND.COM, which was sold for $9, 999,950 on March 11 (SEX.COM was initially reported to sell in 1999 for $12 million dollars, however, that sale did not close. It was sold to Escom, LLC in 2006, but the price for this transaction was never publicly reported).[6]

However, despite these eye-popping prices for generic domain names, domainers report through blogs and other web postings that they are facing increased pressure by auction providers to lower their auction reserves[7] and are frequently disappointed by the ultimate sale price of most of the domain names they sell. In fact, according to Zetitic.com, the average domain name sale is $5900. A far cry from the almost $10 million FUND.COM fetched.

Domainers believe one of the big reasons that their .com generic domain names are not regularly selling for more than the $5900 average is because brand holders are not educated and engaged in the purchase and use of generic domain names. Thus, some domainers believe they are at a disadvantage when trying to perform domain name valuation using the same methodologies used by corporates. Some say that ad agencies do not want corporate marketing directors to learn that while they may spend big dollars to acquire a relevant and short .com domain name to drive consumers to their brand, it is a much smarter spend that the short-lived million dollar ad campaign.[8] However, apparently some big brands have figured out the worth of generic domain names[9]:

- American Express - Open.com
- AOL - When.com, Games.com, Love.com
- Answers Corp. - Answers.com, Reference.com, Dictionary.com, Thesaurus.com
- Bank Of America - Loans.com
- Barnes and Noble - Books.com
- Bayer - Aspirin.com
- Bass Pro Shops - Hunting.com
- Brown Shoe Company - Shoes.com
- Burlington Coat Factory - Coat.com
- Calvin Klein - Bras.com and Underwear.com
- Citibank - Student Loan.com

- CNET - Kids.com, Help.com, Computers.com, Download.com, Online.com, TV.com, Upload.com, News.com, Search.com, com.com, Builder.com, Gaming.com, Shopper.com, Marketplace.com, Updates.com, Store.com, Buying.com, Chat.com, Welcome.com, Browser.com, Shareware.com, Freeware.com, Auctions.com, Labs.com,

Community.com, Silicon.com, Radio.com
- CNN - Money.com
- Diageo - Malts.com, Rum.com, Scotch.com
- Disney - Movies.com, Video.com, 101.com, Go.com, Family.com
- Ebay (aka PayPal) - X.com
- 1-800-flowers - Flowers.com
- Google - Hello.com
- Honda - Motorcycles.com
- Johnson and Johnson - Baby.com
- Kraft - Cream Cheese.com
- MasterCard - Priceless.com

- Microsoft - Live.com, Surface.com, Start.com, TV.net, Investor.com
- Monster - Jobs.com
- Office Depot - Office Supplies.com
- PetSmart - Pets.com
- Procter and Gamble - Toothpaste.com
- Rocky Mountain Bicycles - Bikes.com
- Sports Endeavors - Soccer.com, Lacrosse.com
- The History Channel - History.com
- The Weather Channel - Weather.com
- Travelocity - Vacations.com
- Unilever - Soup.com, Peanut Butter.com
- Yahoo - Contests.com, Broadcast.com

With Direct Navigation continuing to be on the rise, securing related generic domain names arguably enables brand owners to capture searchers and ensure their brand and products are front and center in the minds of online consumers. Recent domain auctions such as, DomainFest and T.R.A.F.F.I.C., have seen an increase in well-known investment and venture capital firm attendance and participation. For example, the Internet Real Estate Investment Trust in Houston, has purchased more than 400,000 domains since its inception in 2005. Among its portfolio are Bands.com, CreditReports.com, and Shows.com. Investment firms like Maveron, co-founded by Starbucks chairman Howard Schultz, and Perot Investment, started by former presidential candidate and billionaire H. Ross Perot, are behind the Internet Real Estate Investment Trust[10]. However, there still seems to be no sign of major corporations at any of these events. Maybe it is time for brand holders to investigate.

Finding your diamond in the rough

Vint Cerf , who is often referred to as "the father of the Internet" once said, "[t]he Internet is a place, an environment, made up of people and their myriad interactions. It is not merely a technology but a new way of cooperating, sharing and caring. Businesses that recognize the human aspect of the Internet will be more likely to find success in the artificial worlds of the Digital Age, for they will understand that the artificial is rooted in reality and reality is rooted in our hearts.[11]" It is these words that help speak to the true value of a domain name. Simply said, domain names that mean something to the target audience will likely yield the highest return and therefore, result in high dollar valuations.

Thus, while many brand holders have thousands of domain names, many are purchased to protect the brand from infringement. These are names that someone may possibly use to try to access the equity of your company and brands. A lot of time and attention is spent trying to outsmart domainers and other brand infringers and beat them to the punch for these names. Brand holders must continue to evaluate these domain names and make purchasing decisions while constantly balancing risk versus cost. However, in order to have a few diamonds among the cubic zirconium, brand holders must connect with hearts and minds of their audience…the consumer. They must think like them and understand their search habits to truly unlock the potential of the online channel and increase the value of their intangible assets. While many of the generic .com domain names are already in the hands of domainers, there is now a window of opportunity where domainers believe that corporate brand holders are not regularly engaged in the practice of purchasing relevant generic .com domain names. Perhaps with a little help, a few diamonds can be purchased for cubic zirconium prices.

Notes

1 See "intangible assets" at http://www.investorwords.com
2 *See eCompanies plans business-to-business Net service* on CNETnews.com at http://www.news.com/2100-1023-233649.html
3 See R.H. *Donnelly to Buy Business.com* on DMNews.com at http://www.dmnews.com/RH-Donnelley-to-buy-Businesscom/article/98019/
4 See *What's in a (Domain) name? Some serious cash Buzz Technolgies, Inc.* says on Domaininformer.com at http://www.domaininformer.com/news/press/080320BuzzTechnologies IncSays.html
5 See *Porn.com Sells for More than $9.5 Million in Deal Moniker Claims is Largest Cash Sale Ever* on DNJournal.com at http://www.dnjournal.com/archive/domainsales/2007/domainsales05-22-07.htm
6 See *15 New Domains Qualify for the Year-to-Date Top 100 Sales Chart This Week Including Two New Top 10 Entries* at DNJournal.com at http://www.dnjournal.com/ytd-sales-charts.htm.
7 See *Auction Reserve Appraisals Cheap!* on Successclicks.com at http://www.successclick.com/auction-reserve-appraisals-cheap_2007_12_28/
8 See *Madison Avenue's Fears of Domain Names* on Successclick.com at http://www.successclick.com/madison-avenues-fear-of-domain-names_2007_12_02/
9 See generic Names Owned by Large Corporations on DomainToolsBlog at http://blog.domaintools.com/2007/08/generic-domains-owned-by-large-corporations/
10 See *What's in a (Domain) name? Some serious cash Buzz Technolgies, Inc.* says on Domaininformer.com at http://www.domaininformer.com/news/press/080320BuzzTechnologies IncSays.html
11 See *Perspectives* on allaboutbranding.com at http://www.allaboutbranding.com/index.lasso?article=113
12 See *Clek Media Inc. Brokers World-Record $10 Million Domain Sale* at CNN.com at http://money.cnn.com/news/newsfeeds/articles/marketwire/0373359.htm
13 See DNJournal.com Weekly Sales Report

Top 11 reported domain name sales of all-time[12]

1. FUND.COM - $9,999,950 (2008)
2. PORN.COM – $9,500,000 (2007)
3. BUSINESS.COM - $7,500,000 (1999)
4. DIAMOND.COM - $7,500,000 (2006)
5. BEER.COM - $7,000,000 (2007)
6. ASSEENONTV.COM - $5,100,000
7. SEO.COM - $5,000,000
8. AUCTION.COM - $4,500,000
9. DERMATOLOGY.COM – $4,500,000
10. HORSERACING.COM - $4,500,000
11. SLOTS.COM - $4,500,000

Top 5 reported domain names sales of 2008 (as of April 6, 2008)[13]

1. FUND.COM - $9,999,950
2. PIZZA.COM – $2,600,000
3. DATARECOVERY.COM - $1,659,000
4. CRUISES.CO.UK - $1,099,798
5. IREPORT.COM - $750,000