DomainMart

Making Sense of Domain Name Appraisals: The B/T Ratio

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Your domain name was just appraised for $2,000. What does the number mean? What is driving its value? Are you equally satisfied with another domain name with the same extension that has the same price?

A simple measure called the brand-to-traffic (B/T) ratio can be used to answer these questions.[1] The ratio is an indicator of the relative strength of these two major value drivers. Below, I focus on appraisals that are derived from sale prices of 'comparables,' which is the most widely used approach and is the least intuitive in terms of the implications for the best use of the domain name.

MAKING SENSE OF THE METHODOLOGIES

The intrinsic value of any asset is determined by its cash flows (CFs) and their risk. This valuation methodology is called the 'income approach,' whereby the CFs represent the stream of present and future net income. Thus, the various appraisal methodologies try to estimate this value either directly by estimating the CFs and risk, or indirectly, with the comparables-based approach being widely (mis)used.[2]

Making sense out of the income approach is relatively straightforward. The appraisal report would include estimates and sources of CFs, their risk, the assumptions on projected CFs, and sources of data.

On the other hand, there are no theoretical models to describe the value drivers for comparables-based appraisals. Thus, the companies providing appraisal services have each adopted their own list of descriptors such as 'branding and advertising,' 'linguistic,' 'length,' and 'extension.' Hence, this approach raises two questions: (1) is there a meaningful, measurable, and parsimonious way to capture these effects? and (2) what is each driver's contribution to appraised value?

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[1] For the methodology used in measuring the B/T ratio, see Alex Tajirian (2006), "Appraisal Based on Estimating the Value Generating Process," DomainMart.

[2] More details can be found in Alex Tajirian (2005), "Valuing Domain Names: Market Approach Methodology," DomainMart.

Both these questions can be answered positively. From the perspective of domain name use, there are only two, not necessarily mutually exclusive, functions: branding and traffic. The traffic component can be further broken down into the domain name's suitability for parking verses forwarding/leasing. The second question, however, can only be answered using statistical techniques.[3] Without a statistical model, appraisers can only provide ad hoc measures for each driver and then aggregate them into the appraised value in some mysterious, proprietary procedure.

Our statistical model divides the appraised value into two components: value of branding and value of traffic. Given an estimate of the two components, one can easily develop a metric to reflect the relative importance of each component to appraised value, and thus, determine the best use of the domain name. We use brand-to-traffic (B/T) ratio to measure the relative strength.[4]

IMPLICATIONS OF B/T RATIO

1. Good vs. Bad Traffic

Although the definitions and measurements of good verses bad traffic are being debated, convertibility of traffic to revenue can be used as a broad measure of traffic quality. It does not require rocket science to realize that one possible reason why a high traffic website is not able to generate revenue is that the domain name may be more suitable for forwarding/leasing than parking. However, until now, there was no metric to determine best use. For example, a domain name with high traffic, a low B/T, and a low PPC rate suggests that it is best suitable for forwarding/leasing. Nevertheless, revenue-converting traffic is a necessary, but not a sufficient condition for good traffic, as bad traffic can also arise from unethical and illegal use of website content.

2. Domain Selection

Two equally valued domain names can have two different uses. Thus, for example, if you have a budget of $2000 and you are interested in parking revenue, you should seek domain names with low B/T ratios and high PPC rates, i.e., high PPC rates is a necessary, but not a sufficient condition.

3. The ratio can be used as a tool to determine the merits of **protecting a domain name under alternative TLDs**.

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[3] DomainMart is the only domain name appraiser that has its statistical methodology made public. Thus, claims or performance of other appraiser's methodology cannot be ascertained.

[4] The statistical procedure is described in a relatively technical White Paper by Alex Tajirian (2006),"Appraisal Based on Estimating the Value Generating Process," DomainMart.