The Fundamentals of a Revenue-generating Website - With David Fairley

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Today's guest sold Shout.com, Kosher.com, and Silver.com, all within the past year. He also has a history of selling revenue-generating websites in the six and seven figures range. How did he get the attention of the buyers to make all these sales? Stay tuned.

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Here's your program.

Michael Cyger: Hey everyone. My name is Michael Cyger, and I'm the Publisher of DomainSherpa.com - the website where you come to learn how to become a successful domain name investor and entrepreneur directly from the experts. Today's guest sold Shout.com, Kosher.com, and Silver.com, all within the past year. Phenomenal domain names. How did he get the attention of the buyers to make all these sales? And how does he get the attention of the acquirers of the website properties he regularly sells in the six and seven figures? We are going to find out now. Joining us is David Fairley, Founder and President of WebsiteProperties.com - a brokerage that specializes in selling established website businesses and Internet business opportunities. David, welcome to the show.

David Fairley: Thank you very much. Glad to be here.

Michael: David, I want to find out how you first started selling websites. In the pre-interview, you told me that it started with a website that you created. What was the first website that you developed, and what purpose did it serve?

David: Well, I got online in 1997. I had been importing hammocks for a number of years. And when the Internet came along, I got on pretty quickly, just because it seemed like the next wave, which I was happy I started. I ended up acquiring the Spanish name for hammocks, which is hamacas, initially. Around 2000, I ended up acquiring Hammocks.com, the English version. So, I had both of those, and I ended up running that site for five years total. Ended up selling that in 2002, and so I got my first taste of exact match premium domains with my own site right out of the gate, which was quite beneficial, having that name.

Michael: Yeah. How big did you grow the business during those five years that you started it to when you sold it?

David: Actually, it started off pretty modestly, but it seemed to double every year. When I exited it in 2002, the site was average about 150 thousand dollars a month in the high seasons. And I think my gross sales were close to a million dollars when I sold it, and so I ended up having a pretty successful exit. It was actually a high six figures. There was an earn-out that was in the agreement, but I never realized that. I think that was intentionally in there and that was probably what encouraged me to move into the appropriate field to begin with, because I felt like I needed to represent people so they would not experience the same thing I did.

Michael: Yeah, and I want to ask you about that, because when I have sold a company in the past, I too had a broker, and it was a phenomenal experience. So, I want to dig a little bit more into that. So, when you sold, it was about a million-dollar business. You say gross because I assume that you had a lot of expenses. You had to import the hammocks, you had to package them up, and you had to ship them out to the potential buyers. You had some returns. You had customer service. All the things associated with the business. How much profit was the business generating per year when you ended up selling it in 2002?

David: The business had a net profit margin around 35%, so it was netting around 350 thousand. It was pretty significant. I mean when you sell a business, it is not based on gross sales, because you can be running a business and making millions of dollars in gross and still be in the red. It really comes down to how profitable the business is, so that is what it was based upon, and that is typically what you are basing a business valuation on; is the net profit, not the gross.

Michael: So, you had hammocks. It is a great niche. I have wanted a hammock all my life. I do not have two trees that are close enough to hang one, but I have thought about installing some posts. You had the exact match domain, which I want to know how much you paid for. Let me get back to that. You were generating a million dollars in sales gross, about 350 thousand dollars per year in earnings before income tax depreciation (EBITDA) in assets or profit. Why did you decide to sell the business? It sounds like a great lifestyle-type business.

David: Well, as I mentioned, I had been importing hammocks prior to that. I actually started that around 1992, and it started off pretty humbly slugging them at music festivals and that hippie lifestyle. It was pretty fun, and then got to mail order and then, of course with the Internet, it was the next step. So, I think it was just that I had been doing it for so long. I wanted to change. I think just getting bored. I had five years online pretty much, and it had gotten to a degree where I think that, at the time, was more than I could manage personally, and I just wanted to change. I mean in hindsight, probably timing-wise, I could have rode it for two or three more years and had a much bigger exit, but after that, I realized too once you have done one thing, there is infinite opportunities to do that. And I have gone on to - over the years, I have owned over 65 websites, either developed from scratch or bought and built up and sold. So, I mean that is what kept me interested. I think I am just the type of entrepreneur that, like a lot of my clients, likes to create. They are creative and they like to develop new ideas, and holding on to something forever is not really my style.

Michael: Yeah, that makes sense. So, with about a 350 thousand-dollar net profit on the trailing twelve months, and you said that you sold it in the high six figures. It sounds like it was a multiple of EBITDA of about two to three times. Is that fair?

David: Yeah, it was designed. Again, the purchase agreement was: I was supposed to have more or less a five-percent earn-out, but the way it was drafted was cleverly disguised as a way, in the end, of not paying me out as I should have been. And not to cry over spoiled milk, I mean I was out-negotiated at the time. I suppose if I had a bit more experience, I would have done it. The way I do it now; what I have learned was that if you are going to have an earn-out, it is either an earn-out as a percentage of gross, because you cannot really manipulate gross. Gross is gross, and it comes right off the top. And we have done some great deals for clients over the years with that. There is a higher upside if you can get that. It is not always a cash deal. Sometimes there is owner financing, which is based on a fixed number. But that was sort of what compelled me; was that I realized after the fact that there was no intention really, or they were not going to pay me, as it turned out. And so, I kind of realized that. I got the wisdom from that experience, and that is what I pass along to clients. In the long run, I just would never do a deal unless it is very, very cut dry and simple. And it has to be written with the right company, or the right player. Earn-outs are not for everybody.

Michael: Yeah, and did you actually use a broker when you sold Hammocks.com?

David: Well, initially, what happened was I did retain a couple people, and one of them was just a cutout scam. I had to pay five grand upfront, and they were absolutely unqualified and they did not do anything for me. They said they had a list. And another person just, again, did not have any understanding of the fundamentals that were unique to Internet businesses. And no one at the time, really, back then - ten years ago -, really had a clue. And because of my background in business and finance, and just my own experience online, I pretty much knew what the fundamentals were; and over time, that has become sort of the norm. But I was kind of the first into this space, really, of valuing and appraising Internet businesses based not only on the bottom line, but on the fundamentals that have to do with traffic and customer database, and SEO, and all those other factors that come into play now.

So, it was just a learning experience, and it has helped me be an asset to individuals that have businesses that are not really sure how to value and not to step on any landmines. I mean that is the satisfaction that I get from my career in the last ten years; is helping people not make the same mistakes I did and actually have an exit where they can feel good about it, because there is nothing worse than selling a really great business and then realizing later on that you did not get paid out what you should have or that there was some other upside. So, that just comes with experience, and it is one of the most important decisions people make, as you would know. When you sell your first business that you have built up and it is your baby, you just do not want to make a mistake, because it can be catastrophic. It can cost you hundreds of thousands or millions, and so that became part of my mission.

Michael: Yeah. So, what was the next site? After you exited Hammocks.com, David, you started up another site. What was the next website that you developed?

David: I think the first thing I went into right from scratch was a site called PuppetUniverse.com. I built that and I ended up having a husband and wife, locally, that ended up taking it up, and I helped them grow that for a number of years. They ran that for four or five years. From there, I did a whole litany of sites. I built and sold site. I mean one was DolphinLovers.com. I had AntiqueCar.com.. I had a BathToys.com site. I mean I literally got to the point where I was building these things from scratch and not even really having any business and pre-selling them to people that wanted to get online.

The next real big one I had was Strollers.com. I acquired that domain, built that site up, did some SEO on it and got it to number one pretty quick. That was an interesting one from a couple standpoints. It was, obviously, a category-killer domain name. Exact match. It is a fairly large niche. I ended up selling it to a couple from New York State, and they ran it for a couple years, and then they came back and they got it up to speed where it was doing a few hundred thousand in gross sales. But by that time, I think it was in 2005/2006, when those kinds of domain names - product domains - were really, really valuable, and people were really trying to grapple and grab that asset in those spaces. And they came to me and they were not really running it like a full-time business. It was more of a hobby thing.

And I put it up on the market and they ended up exiting for close to a million dollars. That was a heck of a deal. They had one of the larger players in the marketplace that was acquiring niche sites bought it. This was one of those deals where it was a great company. I cannot give the exact details of what they paid, but they did a cash-upfront deal and an earn-out that went on for three years, and it was a tremendous deal. It was based on gross, but in the end, I sold it twice, but it was a different timing. Timing is everything. I mean initially, when I sold it, I did pretty well, but it was lower. There were no numbers. It was just a site that had been developed. No sales. And it was really the domain name at the time and an opportunity. These people got it and ended up probably making, I think, in the end, seven or eight times as much as I did after a couple years. Mostly from the domain name, because it was a hot market.

So, the main thing was that they had developed the site and the site was up on the first page for most of the keywords. Had solid traffic. They had not realized a huge amount of profitability, but the domains were so hot at that time, and it just occupied the top spot for major keywords.

Michael: Yeah, so it was ranked well. And even though it was doing business, they were not making a lot of money. It was just a hot market, so it got snapped up.

David: Right.

Michael: Were they doing affiliate links? Were they doing drop shipping?

David: They were selling product. With a lot of companies, you cannot. They were excluded from some of the biggest brands just because they did not have a storefront. That can pose a problem for any niche seller. If you do not have a retail store - brick and mortar store - sometimes they will not allow you to the product line. In the case of the buyer, they were so big and they got in everything. They got all the lines, so they knew that they picked it up. I mean it was a good buy for them. They did extremely well over the time. And consequently, they were extremely impeccable and honored the agreement, and the client (Unclear 14:15.9) the seller ended up doing really well over time, so I was really happy with that. But it is an interesting thing, because it went from a (Unclear 14:22.7) pure domain name, where I bought it for low five figures, sold the developed site with SEO for low six figures, and then essentially got to a high six to seven-figure deal with earn-out over time once it was developed and actually cash-flowing. I think that the timing had a lot to do with the price.

Michael: Yeah, definitely. I know a lot of people listen to stories like that and they say: "Oh, that sounds great. I can do that too." Do you think you can buy a single-word product, category-killer domain name, like Strollers.com, today, knowing that the market search engines are so competitive for keywords like that, and do you think you could build it out and get it ranked and try and move a five-figure purchase to a six-figure purchase today, or did that only work five or ten years ago?

David: No. I mean listen, it depends on the ability of the person. I mean you can build out a category-killer, exact match domain name in a certain way, if you have the skill sets to do six, seven, and even eight-figure payout revenue. It just depends. It is not just based on trying to get SEO tactics. I mean I think that the search engines - Google has devalued exact match domain name's relevancy. It is really content and the product-offering relevancy. Having a great domain name is a great asset, for sure. It is easy to brand. It is easy to remember. It has all that value to it, and people can still come in to play from an SEO standpoint. But I think you would have to develop a good business and create brand loyalty, really high customer satisfaction.

eCommerce has become very competitive. I think the market is still right for disruption in certain niches for sure. I still think that 80% of the people out there with these sites are doing a mediocre job. It is not that difficult to develop a site that has great product mix. It just has a really solid functionality and customer service. Those are really important. Having a great name is just a bonus. I mean it does not make or break a business anymore. I mean you could take a vowel out and have a great name. Now, with sites like LinkedIn and Flickr, or whatever the name is, if you do a good job from a business execution, you can make any business huge, but having that great name is certainly a wonderful place to start from for sure.

Michael: Yeah, just a couple weeks ago, I interviewed the CEO of CarLoans.com.au, and they migrated from Beep.com.au, which was a car financing company. And all they did was change the name, and they increased their business in five months from 60 million in turnover to 100 million turnover.

David: Yeah.

Michael: So, they had a great business before, but with an exact match domain that describes exactly what they do, they were able to lower their customer acquisition costs on Google AdSense and really bump up their total revenue.

David: Yeah. I mean I was really shocked when I sold Silver.com. I thought for sure there was these companies that I had seen advertising on television to buy Silver (Unclear 18:00.1) companies. And I thought: "Well, they are spending millions on MSN and Fox," and these things were coming up daily. I could never remember the bloody name of the company because it was something that was something, something Silver, and I thought, for sure, that these companies would see the value in that, and they were not the ultimate buyer. It was a domain name investor that was planning on developing the site and, to this day, we are not sure what he is doing, but nonetheless, I mean you would think intuitively that a company that was in the market would see that, because it is just like a great 800 number. 800-FLOWERS. I mean Silver.com or Chocolate.com, or whatever it is - you would think that they would want that, and you would be surprised at how many companies pass on that. But your example of this other company from Australia, going from Beep.com.au to this other name just shows you the power of a solid domain name. It can really make a difference.

Michael: So, you mentioned that you were developing a lot of websites, and that you have had a lot of experiences from which you learned and you wanted to share those with other people that were selling their properties so that they did not have to step on the same landmines. I know exactly the types. We were discussing just before we hit the record button those kinds of events, and I have been through it myself as well. And those are hard lessons to learn. It is hard to find an opportunity to learn those. You really need a broker. So, how long have you been brokering websites for people?

David: It is going on eleven years now.

Michael: Wow.

David: And I have done, I think, last count, somewhere around 450 to 500 website businesses sold. We are up. I mean most of the businesses are probably between 50 thousand and five million. I mean the average being somewhere around 250 thousand. Over 50 million in gross sales over that time, which I mean that is a lot of deals in the low six figures, but our market is typically between 100 thousand and ten million. In fact, like today and yesterday, regularly we get a lot of private equity groups that tell us that they are looking for businesses that have at least a million dollars in EBITDA - and God, I would love to - and up to ten million. So, it is not a question of us not having buyers in that range. We just do not have that many sellers that come along that have businesses that are worth more than ten million. I mean mostly, the price range is usually between 100 thousand and five million, but I have buyers that would sink their teeth into ten to 25 million range.

Michael: Yeah, and that sort of is the sweet spot for institutional investors or private equity companies. They want to see an EBITDA of about a million dollars from what I have seen in the past. Is that what your experience is?

David: They will look at things that are half a million and above, but they are really looking. They put teams in place. They need to have that cash flow. And they are looking for something that has more solidity and more history behind it, but also the cash flow is important. I mean I wish I had more inventory a lot of times, in that level. I mean we have a lot of great deals that are between 100 thousand and a million - that range - at selling price, which are great for a lot of buyers and entrepreneurs and investors, but there is certainly - I am just indicating that it is not like I have 200 million or 500 hundred million dollars overall in gross sales. I mean it is just an indication of just having inventory at that level. In any given day, I can get an email from a seller that has a business that is worth 25 million, and we would have buyers for that. We have the ability. An Internet business that is worth 100 thousand dollars has the same fundamentals, typically, of something that would have ten million dollars. It is just a scaling difference.

Michael: Sure, exactly. And so, if you are doing deals that are between 50 thousand and five million, let's say, and your sweet spot is around 100 thousand to a million - not sweet spot, but majority of the deals are happening between 100 thousand and a million, let's just take a 300 thousand-dollar deal. If it sells for 300 thousand, basically their EBITDA is about two to three times multiple of their revenue. Is that correct?

David: Yeah, I mean the long-term average. We have seen most of the deals that we have done, I think, their long-term average is around 2.85.

Michael: 2.85, so somewhere around there.

David: That is actually higher than that.

Michael: So, if it sells for around 300 thousand, they are doing an EBITDA of the past 12 trailing months of about 100 thousand dollars. Is that fair to say?

David: Yeah, it can be 100 to 150. It is a range. It just depends.

Michael: And who are the typical buyers of a 300 thousand-dollar business?

David: Well, a lot of times, the typical buyer could be an Internet entrepreneur that has already been in the marketplace. It can be a husband and wife. The husband might be buying the business for his wife, or they might have retired from a career in something else, or corporation. It depends. Some people that have gone from brick and mortar that want to invest in a business online. Some of them are looking for investments in businesses that do not take up a lot of time that they can invest in that are operating 24/7 and do not take employees. I mean they are looking for what I consider more of a passive income business, but there is nothing really passive. I mean you still have to put time and efforts into it, but it can be done. They can put two or three hours into it in the evening or in the morning, outside of their regular business. There are all sorts of buyers. But I think we have buyers that are high net worth individuals. There are Internet entrepreneurs. There is people from the corporate world that are looking for alternative investments outside of real estate or the stock market. You have got private equity. You have got hedge funds. I mean upper levels. There are Internet 500 companies that get our emails that subscribe, so they want to pick up deals to add to their portfolio. All sorts of things like that.

Michael: Got you. So, I am sure a lot of people are listening to the show and they are saying: "Well, I go to Flippa and I look at businesses that are for sale that are producing revenue as well." How do you contrast your business and the types of businesses that you broker versus those being offered on Flippa?

David: Well, Flippa is an auction-based type of setup, so people could kind of come in there. All the information is typically right there for you look at. Get access to traffic, stats and revenues, and things like that. There is no high level due diligence that is involved. Most of the time, a lot of the deals seem to be under twelve months or a year. They are pretty young. People are trying to turnaround. It is called Flippa for a reason. People have built something and they are trying to flip it and get some cash out of it, without having a lot of historical proof and less due diligence involved. I think a lot of good deals get done under ten thousand. Some upwards of 20 to 50 thousand. They get deals closing above, up toward 100 and sometimes above, but most of the time, people value those businesses. It seems the chatter is ten months to 15 months of whatever the business has done. Sometimes people try and sell on an average of the last three or six months. Not a lot of longevity.

The types of buyers I deal with are more sophisticated. They are looking for something that is stabled and proven and growing, and that has a real history. Tax returns sometimes, so they can get SBA loans on. I mean the typical deal I will be involved in will take 30 to 45 days to close versus Flippa, you are battling out, trying to bid on something, hoping blindly with whatever they have proven, and then they want to close within five days after you are the winner. So, it is a different things. I have bought and sold things on Flippa. It is a different marketplace. There is a lot of naivety that is there, and there is a lot of sharks that exist. So, you have got to be careful, but there are deals to be had there. I mean I still use it. It has got a lot of exposure. Really, it is more about exposure than anything else on Flippa.

I have people that are buyers on Flippa that complain about the valuations that I have, and I am like: "You get what you pay for." People will pay a 3x multiple or 2.5x multiple, or upwards of a 3.5x multiple, if the business has the fundamentals and the trends, and the stability, and the elements that buyers want. I mean at the end of the day, if you buy a business at a 3x EBITDA, you are getting the 33% return on your money, and you own the business that is stable, and you have got a customer database and you have got this track record. I mean that is a better return they are going to get in stock and, a lot of times, in commercial real estate. So, it is a great investment, but there are risks in everything, so you just have to be careful.

Michael: Yeah, definitely. So, if a person has a revenue-generating business and they are listening to you, David, and they wanted to work with you, what is your commission rate for representing a buyer, assuming that you reviewed it and it is a property that you are willing to represent?

David: Our broker commission is ten percent. I mean that is fairly standard in the industry. That is a success fee as well. We do not get paid unless we sell the business, and that is indicative of how we approach who work with. I mean I turn away probably 80% of the people that come to us to sell because our business reputation is such that the subscribers, or the people that get our business for sale alerts, are used to high quality businesses that we have done some vetting on initially, and they have solid fundamentals. And they are business I, myself, like and can get behind. I mean I am not going to try and sell something that is, quite frankly, not worth my time or someone else's. It has to have the fundamentals. It has to have good, solid numbers. It is not falling off a cliff. It has to have the fundamentals that I can get behind and sell and feel good about.

So, we are very careful with who we work with. I mean of course, over the years, we have had a few businesses that have come along where they have turned out to be dogs or they are in the process of falling off a cliff and start becoming a distress sale, but we do not list, typically, businesses that are suffering. Unfortunately, people come to you at the wrong time. If they come to me and they want to dump the business, it is a dumper. I am not interested in selling that. I mean go and sell that by yourself. Our buyers are, again, more sophisticated. They want to buy a business that has upside and opportunity, where they are going to get a good return on their investment and, hopefully, take to a whole new level.

And so, that is what we look for in a business. And yes, we have been caught with our pants down a couple times, but we will get rid of those listings eventually. Certainly, you cannot audit people's financials when you have to base it. There is a good faith aspect, but they have to sign a contract and agreement with us that they are going to present accurate figures and they have to be transparent in that. And if they are not, it is going to come out in due diligence, but that is very rare. We are pretty good at determining whether the business and the business owner are worth our time and our clientele's time on the buyer side.

Michael: So, you represent a good number of revenue-generating websites. You are doing probably 50 website sales per year. Is that number about right?

David: It depends. I mean at any given time, we will have anywhere from 20 to 25 sites/clients that we are representing. In a given year, on a slow year, it is 20 to 25. And on the high end, it can be 50 or 60 sites. It just depends. It is not really about quantity. Again, it is quality. I mean I could take on a lot more business. I mean Flippa has 50 to 100 new businesses a day. That does not mean they are all good.

Michael: Right.

David: There is a lot of schlock on the marketplace, and I am really more focused on quality than quantity.

Michael: How long does it take to close a deal and what percentage of the deals that you have close, David, roughly?

David: Again, our long-term average success is probably 85% to 90% of the deals that we take on close eventually. The average time to sale, I think - we look at this before - was the average site over ten years, three and a half months to close. The average in the industry, from what I understand, is around six months for online businesses, and then offline, brick and mortar can be 15 months. I have had deals that went on the market and, in a day, we had offers, and they closed in two weeks' time. So, it can be fast. It really comes down to how compelling the business is. If it is a great opportunity, the numbers are good, and the asking price is in the fair market range, it can go really, really fast, and depending on the niche as well. I mean some businesses people just go cuckoo over. Like pet-related businesses seem to go really fast. It just depends. I mean it really depends on the cash flow and on the numbers. The first thing people look at when they look at a listing is how much is the asking price and what is the cash flow. What is the profit? And they are going to go: "Okay, well, this is reasonable," or, "This is a really aggressive asking pricing based on the cash flow." What is wrong with this business? It is a game, but you have to get people's attention.

Michael: Can you make any conclusions about the types of businesses that people are looking for? You said pet-related businesses are hot. Is that because a great number of people have pets and they love their pets, and so they can understand it right off the bat? If had a business that was business-to-business related, media that had a fair EBITDA multiple and decent amount of EBITDA, would people be interested in that, or is that something that they would not be because they just do not understand it?

David: No. I guess referring to the eCommerce kind of niche, I mean people like niche sites that they can relate to. It seems like everyone has a pet. So, people tend to gravitate towards businesses they can connect with and they can get passionate about. Of course, there are other buyers that are really interested in lead generation businesses or advertising-based business and media-based businesses - things that they can leverage and grow exponentially in different ways that are not really product-related. eCommerce businesses typically have something. Unless it is drop shipped, you have to handle the product and you have warehousing and other issues, and employees. So, it just depends.

I mean for some people, they want something that is more tangible. Even though it is a virtual business, they like the idea that they are shipping something. For other buyers, they just might like the passive nature of a revenue-based model that is based on advertising and content. And others like subscriber-based models, where every month there is a payment and they can build on that, like a dating site or whatever. There are lots of models out there like that.

Michael: You do not have like a 50% of all the sites you sell are niche-related eCommerce where people do drop shipping. You cannot make a general statement like that?

David: I mean I would say probably long-term. I mean 65% of the sites that we sell are probably eCommerce-based. I mean there has been AdSense and affiliate marketing-type sites, but I would say 65% to 70% of the businesses have been eCommerce, just because there is more people that have built sites like that, and there is more solidity because there is a customer-base. The problem with Google's updates - a lot of the affiliate-driven, content-based sites that were reliant on AdSense have just gotten whacked, and people lost their AdSense accounts because Google says: "You did something. You do not know why."

Michael: Exactly. So, on the eCommerce sites, if you are selling 65% of the sites you are selling are eCommerce-related, are they more on the drop shipping side of the business, where the owners do not touch any products but have to deal with the customer service, or are they more on the side of they import the products, they store them, and then they mail them out when they get a sale?

David: It is probably 60-40, 65-35, something fulfillment to drop ship. So, drop shipping being at 35% to 40% of the opportunities. I mean there is a lot of advantages. It is interesting you mentioned importing, because I imported hammocks, and it just gives you a lot more margin and a lot more flexibility and uniqueness in the marketplace. If you can import a product line, typically the margins are bigger and you have more exclusivity versus buying off of a distributor or wholesaler that is US-based that have other clients in the marketplace, selling the same thing. So, yeah, there is certainly advantages to that, but then you have got warehousing. You have got fulfillment elements and all that.

Michael: Customer service and people not happy, and returns, and all that sort of stuff.

David: Exactly. Drop shipping does reduce the overhead and the amount of time that is required, but you still have to have customer service. You still have to deal with returns and things like that, but it is less moving parts. So, for some people, that is more ideal. But the margins can be different. They can be tighter. And also, things are less expensive; and if someone orders multiple products from you and they are coming from different drop shippers, you can get killed on shipping. So, there are things like that to consider as well in that particular market.

Michael: Can you make any conclusions about the multiple that a business can command based on the type of business it is and how it generates its revenue? Like AdSense versus lead generation, advertising versus a niche, eCommerce site. Does that make a difference or if it is a strong business, regardless of how it generates its revenue, it is going to earn, on average, 2.85 multiple of trailing 12 months EBITDA?

David: I think really the biggest factor is - well, certainly, when you have customer database, where there is reorders, people are buying regularly from you. That is important for long-term value. The way you are getting traffic. I think there is a lot more risk perception out there, and likely so, for SEO, for organic traffic versus controlled traffic that you are paying for and you are making a margin on that. When you control your traffic and there is a cost associated with that and you can scale it infinitely based on your budget and you are still making profit margin, that is more attractive these days than saying: "Hey, I have got all this positioning. I have never been hurt, and I do not pay for anything." I mean that is a risky proposition and I would assume that that is going to go on forever.

The biggest factor, I think, for increasing multiple, other than just having a lot of history and sort of underlying fundamentals, you need proprietary products, or services, or loyalty things, or even subscription base, where there is a reordering history that you can see: "Well, this average buyers is worth X amount to me." When you can factor that in, it is really the growth trend. When a business is growing 20%, 25%, 30%, 40%, or 50% per year, that in itself is going to push the multiple, from my perspective. As someone that appraises businesses, I am going to look at the overall fundamentals, the bottom line, and the last trailing 12 net. And I am going to look at that and go: "Okay. Well, based on these fundamentals, you are in the average. We are going to fall in this fair market range." For something that has really got solid growth and a trend, and has been going for a long time, or is curving upwards, that is going to push.

We have done deals where we have gotten up to as high as a 4.5 multiple. It really depends. I mean for strong growth now, you can get people to pay 3.5 up to four-time multiple. And also, if you have a killer domain name with the business that has got that - a lot of times, when I have got a business that is really, really solid and it has got a really valuable domain name, we often will push for a higher multiple on the cash flow. That is something that I know you wanted to discuss; was the domain name being developed versus on its own. And so, when you have got a business that has really strong cash flow and it has got a killer domain name with it, that usually commands a higher multiple as well.

Michael: Okay. And might that push the multiple up by one time, two times?

David: Well, it just depends. If the business has cash flow at half a million dollars, I mean if you have got a domain name that is worth six figures, you are going to push it to where, if it is making half a million dollars and it is stable or growing, you could probably get a four-time multiple, and you are going to get that because the domain name is great and you can justify that versus just getting three.

Michael: Right.

David: It depends. That is how I would look at it. If the domain name is perceptually worth 25 thousand dollars and you are making 100 thousand dollars per year, you can push the valuation, but you are not going to get as much of a bump. It just depends on the cash flow and how much the cash flow is worth.

Michael: Right. And can you make a correlation between cash flow and the multiple? So, for example, if it was a 100 thousand-dollar business per year cash flow, it might be a two to three times multiple, but if it was a million dollars cash flow per year, you might get five, six or seven times the multiple of cash flow. Is there some correlation there that a higher cash flow business produces a higher multiple in the sale?

David: It really depends on the business model. Again, if something is producing a significant cash flow and it is up in the millions, you are going to attract a different buyer. For example, what we were talking about earlier, like these private equity groups. They have got other people's money. If they see something that they can scale and throw money at and build up, a lot of times these guys want to roll together these businesses and they are going to put it into a shell company and try and put it on the public market. They might be willing to pay more for it. But more money and smarter people does not mean that they are going to throw more money at someone. It really depends on the business.

I mean if the business has got higher barriers of entry, it showing growth and it has got a business model that can be scaled if more resource is thrown at it and it does not have a cap to it, then someone that has a lot of money, like a private equity group that is sitting on 30 million that is going to come in and say: "You are making a million dollars. We will give you five million," I mean that is really on the high end. I mean look, it is not like the S&P were companies trading at 19 times the P:E ratios. That is a total different game.

Michael: Exactly. Hey, David, I have seen people saying that the valuation should be based off of revenue, and not EBITDA or profit or cash flow, however you want to refer to it. Is basing a valuation on revenue incorrect?

David: Yes. I mean you can be losing. Like I said earlier, you could be doing five million dollars gross and be losing money. Really, that does not do anything. I had recently, a couple weeks ago, someone approached me that had a business that was doing - they said, in their email, "We were doing about 4.5 million in 2012. We are on track to do six million." And I was like: "Wow, that sounds great." When I got on the phone with them, they are on six million dollars in sales and it was in the furniture niche. They were going to have 150 thousand dollar net and I was like: "What do you do with that?" That is so low. I already know that that is below. That is like 2.5% margins. It is just not going to be of interest to anyone. I mean that is a lot of volume without really any profitability. I did not take the deal on because I think I was going to have more questions arise from the margins versus what the sales were. And the more I dug into it, it just looked like a business that was not run well, and people want to buy businesses that are run well that have good, solid margins. 12% to 15% is on the low end. If you are doing a high, high volume, that is okay, but people like to see something like 15% to 25/30% profit margin. And the higher the net profit, the better, but buying a business based on evaluation of revenue is really just buying in the dark. I mean that does not mean anything.

Michael: All right, let me ask you another one. On Flippa. I see people posting businesses all the time. And we have discussed this. Flippa is people starting up something and trying to flip it. But they will say things like the business runs itself and the owner does not have to spend very much time or half an hour a day answering emails or something. Is that a red flag? Should people be concerned? It sounds like they have got a goose that is laying the golden eggs, but they are willing to sell it for ten thousand dollars. Things do not add up. Have you experienced that in the past as well?

David: Well, really, sometimes it could be a red flag. I mean I have had a lot of sites that were pure passive sites that I bought and added content to, and they had good SEO position, and they would just get AdSense or affiliate commissions. And I had a Snoring website, for example. It was a StopSnoringRemedies.com or something like that. I cannot remember what it was. I have forgotten the name. It was a while ago. But I just bought it and I put up some AdSense on it and some affiliate programs with product, and I just let it be. I knew how to do some good SEO at the time. It is not relevant anymore, but it was basically I did the work initially and then it just made passive income. So, I did not answer the phone. I did not have to do much. There are sites like that certainly, but I do not think there is really truly any passive site. I think if you stop working on a site, at some point it is going to atrophy. I mean you have to add content and you have to do things to sites.

And if it is an investment, some people just get bored. They just let them linger and slowly, over time, they atrophy. But I think that for a particular business model, if someone says they are not answering the phone or doing something with certain business models, I would definitely want to know and dig a little deeper. It just depends. I mean there are sites that are just set and go. People just put on autopilot and work, but I do not think that you, as an end buyer, can expect to spend. Whether it is ten thousand or a hundred thousand or a million, you are not going to buy a business and not do anything. You have got to be proactive and the more you put into something, the more you are going to get out of it obviously. But you have to be careful with some of these bylines that absolutely do nothing.

Michael: Exactly.

David: You really have to be careful and you have got to really check the traffic and make sure that they are not redirecting traffic from other sites. I mean there are scammers out there and unethical people for sure. And I think, ultimately, the more information that someone can provide, the more history they could provide, the safer it is going to be, and in due diligence, if someone is pressuring you to close really quickly when you have agreed to buy something, you should be wary. I mean they should be able to prove everything they have said and they should be able to be very transparent.

Michael: Yeah.

David: Transparency is important.

Michael: Definitely. Hey David, we have talked a lot about multiples of EBITDA for setting the price. When I sold my company, that was the biggest issue, the biggest determination of the value of the company. But what if a seller has a list of companies, customers, a newsletter list, an enormous amount of social media fans? Clearly all of those are used to help drive the revenues, but do they have any value in the purchase price separate from the gross profit that the company is producing?

David: Well, certainly, a lot of traffic definitely can be useful. It can be useful to the buyer in other ways. The thing is that I always question is: "Look, you have got all this traffic. You have got all these people. Why haven't you been able to monetize this and why do you think that this is worth so much if you have not been able to do anything with it?" And sometimes I think the answer is simply they have tried and they have not been able to, and they are not really telling you. To other people though, if the traffic and the niche is really targeted, it can be extremely valuable to a certain buyer. But at the end of the day, it really depends on what it is. If we are talking ten million visitors a month, that is going to be very valuable. I mean there has been sites that were educational and whatnot, but that is going to be valuable to someone and you can try and come up with some sort of appraisal value of that depending on the niche certainly.

But I always wonder why people have not monetized that. When you have got that kind of traffic, there is something. If they have not done anything with it, it is either, in rare cases, they are extremely naive or just do not care; in other cases, something has happened. They have done something and they got penalized by Google. They lost their revenue and they have not figured out how to do something with it. There is just things. You have to be careful with how you appraise things. I think most people; when they are paying money, want proof. They want to buy a concept. There are people that are really experienced that will buy a business certainly just because of the traffic and the quality of the traffic and the niche, but the valuing of something like that is a little bit trickier. It really depends on really what it is, but I think you have to be up in the millions for that to make sense. And maybe it is in video game playing, online gaming, or some sort of niche like that, that can be translated if someone else could take it and redirect it and utilize it, but the formula for that is you are not going to get paid millions for that. We are not talking Twitter or YouTube, or traffic like that. It is obvious that you are going to scale to something just enormous and be monetized down the road.

But certainly, in those cases, yeah, if it starts doing that, it is very valuable. It really depends on the niche though, I think.

Michael: Yeah. How do get revenue-producing websites in front of the greatest quantity of qualified buyers?

David: First and foremost, we have developed a business over ten or eleven years as brokers, where we have got people subscribing and we just do not have a lot of atrophy in that. Because we are respectful of our clientele, we do not bombard them with a lot of emails and what we do send them is valuable to them, and they are interested in seeing those. And that has been building over years. We have got over ten thousand double opt-in subscribers, and we just do not see a lot of atrophy in that. So, that is the first thing. Secondly, our website has been around for a long time. It is reputable and people know about it, and they come there and we have some search engine positioning. We have stopped for whatever reason (Unclear 53:53.7) in organic positioning, but we do not rely on that at all.

There is actually a lot of big business for sale portals out there, and our listings are in all those. We spend a lot of money on our clients, and advertising the premium sections for our clients, and that brings in. People that are looking in these portals - there are seven or eight of them, along with our own listings. And when you see a listing from us, they will come to the site and they will see the other listings. And also, people that are actively looking are going to see all of our listings and they will start realizing that this company has significant properties for sale that are good quality, and that is how it works.

Michael: Yeah, I want to ask you a couple questions about due diligence, David. We mentioned that when you sold Hammocks.com, you did not have the greatest advice from the couples of brokers that you brought on. I had a phenomenal broker when I sold my media company in 2007/08, and I would highly recommend it to other people. So, my first question is around the brokers. How does a seller know if a broker is competent and experienced to represent their business?

David: Well, first off, you could tell, I think, pretty quickly when you speak to a broker how well they are familiar with the landscape just by what they say. I mean what kinds of questions they are asking you. And I think that is going to be specific to Internet businesses; of talking about the fundamentals, about what kind of traffic they are getting. The niche and what the business model is. What the financials are, whether trending. What the average price point is of the product. What is the reorder or frequency with the business? They are things that you are going to know to ask. What the competition is doing. What makes your business special as far as proprietary? Do you have special relationships with vendors? Do you have proprietary software that you are running? What is the platform? What are your expenses?

If they are not asking you questions about what expenses you are running or how many employees you have got, or how much are you peeling off for cash flow, there is going to be obvious things. The other thing is, is how they are going to market their business. Who is looking at your business? The reason for people to come to a broker is because they do not have the experience, they do not have the contact with buyers, and they do not know the type of deal structures that could be done. That is where the experience of a broker is going to come in. One of the questions I get from people that are maybe a little more savvy or they think they are more savvy is: "Well, this broker over here said they will take 8%." And really, 8% on a million-dollar sale might mean is a 100 thousand-dollar commission. Well, if you get 8%, you are saving twenty thousand dollars, but that broker might lose you two hundred thousand dollars.

So, you have saved yourself twenty and lost 180, because that broker was not able to bring in better-qualified buyers or more buyers, or understand how to negotiate a deal that was better. So, experience is really, really important. And I am not the only broker out there. I probably have more experience collectively online as an Internet entrepreneur and as broker than most people out there, but there are competent brokers out there. I think it is about who you are going to work will with and how they are marketing your business. We have accumulation of high caliber buyers that we have nurtured and been respectful for over a decade. That is really big and it is across the spectrum, and we also spend a lot of money and time preparing our clients. And it is about preparing your clients.

You cannot go to market and just throw something out there. Sometimes it takes three to four weeks to get someone prepared to go to market, and preparation is in the prospectus that the information is collated and properly presented with all the information that buyers want to see. And we address 95% plus of the questions that are going to come out, and that is an ongoing, moving process. So, we continue to try and create robust documentation that allows buyers to act quickly, move through the process and make offers, and that is really important. So, it is about preparation, it is about marketing, and it is about knowing how to get deals done and what a fair deal is. If a broker tells a buyer, like: "Oh, I can get you five times multiple," or some ridiculous number just to get you in the door, and then they come back and ask you to take a two-time multiple on something, that is not going to be a happy customer.

We do not try and pander to someone. I actually ask people a lot of times what their expectations are. What they understand to be the valuation based on what they have seen or heard, and sometimes they way undervalue what they are doing and sometimes they are just Blue Sky kind of thinking.

Michael: Right. So, is it fair, David? If I went to a broker and I wanted to sell my business, and they said, "Oh, I can get you a five times or a six times multiple," is it fair for me to say: "What other businesses have you sold that are similar to mine that you got them a five or six times multiple," and then for me to actually call those business owners and verify it? Should I be doing that kind of due diligence on a broker before I sign a contract with them?

David: Well, it is like the real estate market. I mean there are comps out there. You can see Internet businesses sell within a certain range, and you can get a sense of what that is. I mean the market is pretty efficient in working out what the range is. Businesses are more valuable to some people than they are others, depending on what they are, and it is worth what someone is going to pay. But just like a house down the street sells that is a three-bedroom house, if you have got a three-bedroom house and it has similar features and square footage, it is going to sell within a specific range. Maybe you have a nice deck and better landscaping, so that is going to improve it. But with an online business, it is going to be similar. If it is an eCommerce business that is trending and has certain fundamentals and it is stable, it is going to sell in a certain range. And everything is a negotiation. It has to be fair for both parties. I mean in the end of the day, two parties have to come together and agree.

Michael: But there are no multiple listing services for business online. How do I go and figure out businesses that have sold, what their attributes are, and what the sale price was?

David: Sorry, can you repeat that?

Michael: So, for houses, in your example, there is an multiple listing service (MLS), where I can actually go in and look at house prices, what they sold for, what their square footage is, what zip code they are in, what school district, and all the things that value a house. But on the business side, there is no multiple listing service (MLS) for businesses that have sold where I can go and look at the attributes or qualities of the business, what their cash flow was, and then figure out what the sale price is. So, to your point, how do I go and find out what the comps are for online businesses?

David: Well, I guess you can see what the listings are for these things based on their profits and look at that. And then, if you are inquiring, there is basic information that is presented upfront. And then, if you are actively looking, as a buyer, you are going to get the prospectus sent to you. As a seller, unless you are requesting information and getting that, you are not going to necessarily know, but you are going to have a range of what these sites are selling for and what they are listing for. I mean not everything sells for what the asking price is, but there is a range, so you are going to know that, okay, this site is asking 325 thousand and it is doing 100 thousand. They are asking a little bit more. You are going to have to sort of extrapolate a little bit and say this probably sold between 250 and 300 thousand dollars.

And those questions are questions that a seller is going to ask a broker. When they ask, "What is my business worth," they are going to have an idea, but the reason why they are coming to a broker is they do not want to make a mistake. They want to get the best value they can within that range, and they need someone that has the expertise and experience to present it in a way that can justify an optimal price.

Michael: Yeah, definitely. All right, David, here is the final question for you. What is your advice for a domain name owner that does not have any development experience, but wants to add value to their domain name? So, they want to be a domain name developer. They want to create a revenue-producing business, but they just do not have the experience. They have the great names. What would be your advice for somebody that is willing to invest the time and maybe some resources to go down that path?

David: Well, there are different ways to approach that. I mean I think there are a lot of people that do not have the skills and do not want to take the time, and that is nothing, so they just sit and hold and wait till someone comes to them and makes them an offer, or they put it in the active market and hope they get some number that is, I think, still to everyone's agreement is subjective. It is a subjective market. I mean it has been speculative at best and it is an ebb and flow. We have seen some really outrageous prices and things have popped and gone back down and rising back up again. So, it depends on the timing. For someone that wants to develop a name, I am firm believer in developing a great domain name. And if it product or service-based, then if you can develop it, the chances are you are going to make money with this on its way and it is going to create more value to it, and especially if you get it up well above what the domain name would be valued on its own.

If you are not skilled at that, then either you outsource to a company that can help you develop the site, or build it for you, or you find a partner potentially that will come in as an equity partner. They develop and run this thing for you for a stake in the business, and that has been done as well. So, you can do joint ventures. If someone is really not confident in developing a great business model, then there has been a lot of success with people that have said, "Look, I have this killer domain name in the insurance business or in the auto business, or in this related service thing, legal or whatever it is," and they partnered with someone that has the resources, who comes in and develops the business and develops out the model. I would do that with someone that has some track record. You do not just do that with anyone, and then you get somebody and you create a contract, and do a joint venture. And maybe you say: "Look, we are going to develop this thing. We are going to do 50-50 on the revenue, on the profits, and when we sell it, you have 25% stake in the business overall," or whatever. Maybe it is 50%.

I would split the revenues and try and retain more equity in the business if I was in that situation. That would be my recommendation. Get more upfront. If someone develops it and starts creating cash flow, then do not be greedy with the cash flow, but retain the overall value and the rights to sell. So, when you are prepared. If that particular joint venture partner wants to buy it, give them first right to acquire you out based on fair market. And that is a really good approach, I think, for someone that wants to do that. Find a partner that really has the skill set and has the track record to create an incredible business model and go that route.

Now, the caveat of that is - here is the thing that people have to know - that they are sometimes developing a domain name that does not get traction and is not making money and can work against you in the valuation. A domain name that has not been developed in the imagination of a buyer might be worth a huge amount, but once you develop a site, if you fail to execute and it just making a small amount, people are going to ask you about those numbers and the traffic, and customer-based things. And they are going to want that data and then they are going to go: "Well, how are you getting to this valuation," because you have not been able to prove that concept. So, I have a domain name right now that I cannot name, but we ran into that. The alternative is that you can just remove the name and re-park it if it does not execute, I suppose, but for people that dig a little more, they will go into Archive.org and they will see that you tried something.

So, it is a little bit of a double-edge sword. I mean you have got to be confident about that. But I think that in the long run, I think it is worth developing. Trying to develop a site, creating cash flow, and building more value. There is a lot more money to be made in the long run out of that, if you execute well, than trying to just hold and hope someone is going to give you your seven-figure payday on just a name.

Michael: Yeah, great advice. If you have additional questions, please post them in the comments below and we will ask David to come back and answer them. David, if people want to learn more about working with you and they want to contact you, maybe ask you some questions, scope out their business for sale, how can they best get in contact with you?

David: They can go to WebsiteProperties.com, and our contact information there. They can also send an email directly to me at DFairley@WebsiteProperties.com. The easiest is just go to the website. Our phone number is there, our email is there, and they can check out our website, our listings, and we do free appraisals, both for straight domain names and also for established online business, and so we are happy to do that. And it is a great resource for both buyers and for sellers. You do not have to be in the market to sell right, but eventually everyone is going to have an exit, so it is good to learn where you are at and maybe get an indication of is it time to sell. There is a lot of questions. We are pretty straightforward and we are going to talk truthfully to people and tell them what we think. And if someone is at a point in their life cycle of their business where it does not make sense to sell at this point or it makes more sense to hold it, we are going to tell them that and we are going to give them the straight goods on what we figure the business is worth, and then they can determine whether the timing is good for them at that point. But yeah, WebsiteProperties.com, and they can communicate to us that way.

Michael: All right.

David Fairley, Founder and President of WebsiteProperties.com. Thank you for coming on the Domain Sherpa Show, sharing your knowledge of brokering domains and website properties, and thanks for being a Domain Sherpa.

David: Thank you very much for this opportunity. I have really enjoyed it. Hope it has been helpful.

Michael: It has. Thank you all for watching. We'll see you next time.

Watch the full video at:
http://www.domainsherpa.com/david-fairley-websiteproperties-interview/