Masters of their Domains

Forget condos and strip malls. Domain names, the real estate of the Web, have been delivering far greater returns. How some of the savviest speculators on the Net are making millions from their URL portfolios.

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(Business 2.0) – On a balmy night in late October, hundreds of partiers, most sporting red or blue Hawaiian shirts, pack the Delux nightclub in Delray Beach, Fla. It's a swank place--outdoor decks, two bars, plush, bed-size sofas scattered throughout--and the crowd arrives in chartered buses and stretch Hummers. Many head straight for the guy rolling cigars and toss back shots as if it were 1999. Which, to them, it might as well be.

They call themselves domainers. They make their living buying and selling domain names and turning their Web traffic into cash--lots of it. They have gathered in Delray Beach for a trade show called Traffic that this year boasts 300 paying attendees, more than twice the number that came for the first show, in '04.

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The man behind the conference, Rick Schwartz, couldn't be happier--and he isn't even around when midnight strikes and bikini-clad women take to the dance floor to raffle off prizes and peel off their tops. Schwartz, 52, began buying up domain names 10 years ago. Like many early players, he gravitated to where the money was: porn. He snapped up names like Ass.com, Makeout.com, and Porno.com, to name a few. It was a quick path to riches: Adult sites were paying handsomely for the traffic; mainstream sites were not--at least not yet.

Today, Schwartz owns about 5,000 names, with less than a third falling into the "adult" category. He's the industry's biggest promoter, preaching the power of domains to anyone who will listen and bringing domainers together with moneymen and execs from the likes of Google and Yahoo. He sports a $65,000 Rolex on his left wrist, a $32,000 diamond bracelet on his right, and is astounded that he--a community college dropout--is living like a king in a waterfront house in Boca Raton.

"I don't like to work," Schwartz says, almost yelling as if to convince everyone within earshot that they're fools if they do. "I figure any moron in the world can generate work for themselves and tie up their time. I have one laptop, no employees, and no product whatsoever--none! This is magic." Magic, he claims, that's earning him $2 million a year.

And you thought the domain grabbers vanished with the dotcom bust. The boom in Internet advertising and the success of the pay-per-click ad model are making the go-go '90s look sluggish. Back then, buying a domain name was pure speculation: Snap up Whatever.com and sit back until some big company with a get-on-the-Internet-at-any-cost mentality offers you a set-for-life payday to buy it.

Now it's all about the income stream. A single good domain name--Candy.com, Cellphones.com, Athletesfoot.com--can bring in hundreds of dollars a day, in some cases while the owner hardly lifts a finger. Schwartz, for instance, directs his traffic to one of the many small companies that serve as go-betweens with Google and Yahoo, the two giants that make this all possible. The middlemen, known as aggregators, do all the heavy lifting, designing the sites and tapping into one or the other of the search engines' advertising networks to add the best-paying links. Many other big domainers cut out the middlemen, creating their own webpages and working directly with Google or Yahoo.

The secret? It has to do with what's known as type-in traffic, or, in Wall Street jargon, direct navigation. Though it may seem odd in the era of powerful search engines, it turns out that millions of Internet surfers don't use search at all. Instead, they type what they're looking for right into the top of their Web browser. Looking to buy candy? Type in Candy.com, a name Schwartz bought in May 2002 for $108,000. A page filled with links to candy-related products comes up. Click on one of the ads and the advertiser pays Google, which in turn sends a share to Schwartz and the company that runs Candy.com. Some days Candy.com makes Schwartz $300 in profits; the site paid for itself in a year and a half.

No one knows for sure how much Web traffic comes from type-ins, and Google and Yahoo execs won't discuss it. But privately, during one of the late-night parties at the Traffic conference, one Yahoo official estimates that type-ins could make up 15 percent of its search business. Marchex, a Seattle-based public startup whose strategy rests largely on type-in traffic, estimates that it accounts for nearly 10 percent of the global paid search market, which is projected to soar from $9 billion this year to $23 billion in 2009.

That's why some domain names are commanding six- and seven-figure price tags and attracting big-money players. Private money manager Stuart Rabin is cutting those sorts of checks to domainers two to three times a week. In November 2004, Marchex shelled out $164 million for a single domainer's portfolio. Even a few venture capital firms are now placing bets. Earlier this year, Boston-based Highland Capital paid $80 million to acquire BuyDomains, a company with 500,000 names, according to people familiar with the deal. Says Highland principal Richard de Silva, who wouldn't confirm the price, "These are profit machines."

Domainers have their heroes, and one of the most mysterious is a man named Yun Ye, a Chinese citizen living in Vancouver, British Columbia. He is credited with boosting the entire market when he sold his portfolio of more than 100,000 domains to Marchex. His names were bringing in more than $20 million a year in revenues--and $19 million in profits--when Marchex paid the equivalent of 8.6 times annual earnings, based on figures provided in SEC documents.

"He is our god," says domainer Michael Bahlitzanakis the moment he hears Ye's name uttered at a Delray Beach party. Every domainer knows of Ye, but few have ever met him. He's the domainers' Keyser Soze. "My attorney happens to be his attorney, but that's as close to him as I can get," says Bahlitzanakis, 29.

A onetime hotshot programmer, Ye used his software chops to build the bulk of his domain empire in the late '90s and early 2000s. He became a master at what's known as "catching," or buying up domains that were dropping because people gave up on them or forgot to pay the annual registration fee. At the time, the system was secretive, and domainers were trying to figure out what names were expiring and when. In the dark of night, Ye would sit before a bank of computers and, like a conductor, launch programs he wrote to shoot rapid-fire requests to purchase names.

His prowess quickly became clear. Chad Folkening, a domainer in Indianapolis, was disorganized in those years and sometimes missed renewal deadlines. He noticed that Ye was grabbing his expired names with lightning speed. After Ye had snapped up 100 of them, Folkening decided he needed to talk to Ye. "I was eating, sleeping, and drinking Yun Ye," he says. E-mail drew no response. Nor did phone calls. So in late 2001, Folkening traveled to an address near San Jose listed on Ye's domain registrations. "I figured I was going to walk up to his front door, knock, and say, 'Yun Ye, I just had to meet you,'" says Folkening, who now owns 7,000 names. Instead, the address led him to a Mail Boxes Etc. outlet. Folkening stuck Post-It notes on Ye's box asking him to call. Ye sent Folkening an e-mail a couple of days later, but the two never met up. Two years later, some acquaintances of Folkening's set up a get-together with Ye in a Los Angeles bar. "I did most of the talking, then he left," Folkening recalls. It wasn't until the next day that it dawned on Folkening that the man he'd had drinks with was probably an entirely different Yun Ye, which the real Ye confirmed to him in an e-mail. (Ye's attorney, John Barryhill, says Ye won't talk to the press, and he adds, "I don't answer questions about him.")

When Ye was building his portfolio, there was really only one way to make money from names--reselling them. That began to change in 2003 as paid search--developed and pushed by Overture, now part of Yahoo, and current market leader Google--started to take off. The technology powering the whole thing is complex, but not the basic business model: Advertisers pay only when someone clicks on their ads. And to get their links listed high in search results--or on a domainer's page that someone lands on by typing a name into a Web browser--they bid on keywords.

Generic names are gold for domainers, but names that target a specific audience are also valuable. Take, for instance, people looking for information on anorexia or bulimia. Type the phrase "eating disorders" into Yahoo's search engine and an ad from Remuda Ranch treatment center in Wickenburg, Ariz., appears across the top of the results. To win that spot, Remuda pays Yahoo handsomely--$3.06 per click was the price when Business 2.0 checked in early November. But the way many people looking for the same information go about it is to type www.eatingdisorders.com into their Web browser. That takes them to a page with five links to treatment centers, and again Remuda sits at the top of the page. But here's the difference: Click on it from this page and the $3.06 Remuda pays Yahoo for the referral gets shared with the domainer who owns the name.

In this case, that's Frank Schilling, a reclusive man who has quietly become one of the world's most powerful and respected domainers. Schilling bought the name in late 2002 for $1,100, snapping it up in an auction. It struck Schilling as a smart one to own since eating disorders are common. "What I didn't realize," he says, "is that more than 100 people a day blindly type the name into their address bar." Today, he says, the site gets around 120 click-throughs a day, providing steady, easy cash.

Ironically, Schilling came close to selling off his portfolio at the same time as Ye--until Vice President Dick Cheney inadvertently persuaded him to keep building his business. It was the evening of Oct. 5, 2004. Schilling, who is 36, was monitoring his sites from the Ritz-Carlton in Naples, Fla., where he and his family had been living since Hurricane Ivan leveled their house in the Cayman Islands a month earlier. As Schilling was scanning traffic data, he noticed that something wasn't right. An enormous burst of traffic was threatening to take down his servers.

He pulled up Google News, quickly discovering the culprit. The vice presidential debate between Cheney and Sen. John Edwards was going on, and to defend his record, Cheney told viewers to look at Factcheck.com. Cheney had meant to say Factcheck.org, a site run by the University of Pennsylvania. Factcheck.com was one of Schilling's.

Schilling had two options: Take down his servers, which could cost him tens of thousands of dollars in traffic to his other sites, or redirect Factcheck.com surfers elsewhere. The onslaught was useless to him, after all, since he only makes money when a visitor clicks on an advertiser's link. No fan of the Bush administration, Schilling thought of an anti-Bush ad that financier George Soros had run in the Wall Street Journal. Seconds later, he pointed the surging traffic to GeorgeSoros.com, so that anyone seeking out Cheney's record--and many millions did--was greeted with the message "Why We Must Not Reelect George Bush."

For Schilling, it was an epiphany. At the time, he had an offer on the table to sell his portfolio for more than $100 million; the potential purchaser, whom Schilling won't disclose, was in the middle of auditing his business. The experience--a flood of people surging across the Internet and ending up at a page he controlled--made Schilling realize that the value of domain names would become exponentially greater over time. "A few keystrokes and look what I did," says Schilling, flipping back his shoulder-length blond hair and typing into the air. "It was totally surreal." Since the night of the debate, he's added another 100,000 names to his portfolio, bringing his holdings to more than 300,000--cash-generating generic names that are again attracting well-financed suitors.

One of those suitors is Rabin, a soft-spoken man who keeps a white handkerchief tucked into his suit jacket pocket. Rabin runs a private fund called Jacobson Family Investments from the 56th floor of Carnegie Hall Tower, a suite with sweeping views of Central Park and uptown New York City. It's a fitting view, since the Internet in 2005 looks to Rabin a lot like Manhattan 100 years ago--awash in real estate opportunities.

Rabin teamed up a year ago with a Harvard-trained finance whiz named Bob Martin and domain speculator Marc Ostrofsky. They named their company Internet REIT and, according to Ostrofsky, are spending $250 million, probably far more, buying out domain owners as fast as they can find good names. (Ostrofsky, for the record, was the man who pulled off the much-publicized sale of Business.com for a reported $7.5 million in December 1999.)

When Martin and Ostrofsky approached Rabin about forming a business, Rabin knew little about domains. Then he did some research and was astounded. Type-in traffic is a growing phenomenon, the fixed costs are minimal, and U.S. advertisers are expected to spend $26 billion on the Internet by 2010--roughly double the current level. He immediately thought of the billboard industry a decade ago, before Clear Channel and Viacom bought up the small operators. "We've only just begun the roll-up phase," says Rabin, 39. "This market will likely be in the billions."

The team of Martin, Ostrofsky, and Rabin is working the Delray Beach conference hard. Ostrofsky, the salesguy, dives right in: "What are your names? What's your monthly traffic? What kind of multiple are you looking for?" Ostrofsky pulls aside Bahlitzanakis, the Ye worshiper. Bahlitzanakis, who works from his apartment in Queens, N.Y., owns fewer than 100 names, but at least one is a gem: Cellphones.com. The site--a plain page with relevant links--makes an average of $1,300 a day.

Bahlitzanakis spends his last night in Delray Beach at an Internet REIT party, tossing back Grey Goose vodka and tonics. He returns to his hotel room in the early morning to find a contract under his door. Total price: $4.2 million. He paid $90 for the name in 1996. "I just went to my 10th high school reunion, and I thought to myself, 'Who's laughing now?'" Bahlitzanakis says.

Ostrofsky talks about fuzzy concepts like "mindshare" when it comes to evaluating a name. But like all the top domainers, he and his crew also analyze traffic data. Internet REIT figures it will run some of its sites, like Officesupply.com, as virtual stores, with links to suppliers and products. But they're expecting that the pay-per-click model will drive the business.

From his office in Houston, Ostrofsky trolls the Web late each night to find prospective sellers. That's how he ended up negotiating with Marie and Bob Benz at their home in Philadelphia one evening in September. The couple, both doctors, began buying names in 1995 as a hobby. They bought some they liked--Heartdisease.com, Highbloodpressure.com, Athletesfoot.com. In some cases, they developed the sites and added content; in others, they set them up as simple landing pages with relevant advertising links.

After an evening of talk, Ostrofsky and the Benzes reached a deal, and Internet REIT is paying $3.6 million for their 101 names. Says Bob Benz, who specializes in kidney diseases, "It's a lot more lucrative than being a doctor."

Plenty of things could spoil the domainers' party. Internet advertising could turn south. Click fraud, in which someone writes a program that repeatedly clicks on paying links, could become a bigger problem for the paid search industry, making advertisers reluctant to spend. The model itself could change entirely. Or sites could become so commercial that Web surfers sour on them.

But the way domainers look at it, they own the property. "And if you own the real estate," Rabin says, "people are going to wind up there at some point." Soon, he figures, Wall Street at large will begin to catch on, providing opportunities to tap into the public markets. Then big Internet players like Rupert Murdoch or Barry Diller could buy out the domain owners. Some even speculate that Google or Yahoo--or Microsoft, which is entering the paid search business--will roll up the domainers, cutting out a layer and serving up the type-in traffic directly to their advertisers.

In the meantime, Google and Yahoo are trying to keep the type-in business coming--and execs from both companies are using the Delray Beach conference to court the folks who control it. As the party at Delux winds down, 14 Yahoo executives pile into a stretch Hummer with a few of the domainers, including Schilling, who has an exclusive contract in which Yahoo serves all the ads for his sites. The limo heads 35 miles south on Interstate 95 to Scarlett's Gentlemen's Club. The men kick back in the VIP section, outfitted with plush booths and red velvet curtains.

When the woman in charge of the area comes by and mentions the cost of the booths, the Yahoo crew gets nervous. And in the end, no one wants to submit the $1,000 tab to the expense department back at headquarters. Finally, Schilling pulls out a roll of cash and pays up. Not a big deal for a guy who owns a share of a jet. But considering that Schilling's traffic generated more than 1 percent of Yahoo's $3.6 billion in revenues last year, you'd think one of those guys could have stood up and taken one for the team.

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