

Staying **AFLOAT** in the Claiming Game

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To the Reader:

This guide is intended to provide direction for those seeking to increase their opportunity to become and remain profitable in the thoroughbred racing business. The advice given is intended for general guidance. Any decisions, purchases, or contractual relationships entered into should be reviewed carefully. Investing in racehorses contains risk.

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I. INTRODUCTION

THE LEARNING CURVE - OUR HARVARD EDUCATION

AN EARLY PARTNER IN THE THOROUGHBRED BUSINESS REFERRED TO THE FIRST DOLLARS WE spent as “the equivalent of the price of a Harvard education”. Early on, this declaration seemed more like a “badge of honor” than an indictment on our business skill or expertise. As time passed, however, an ever-increasing sense of frustration began to temper our attitudes and confidence as we boldly pressed on trying to find a “winning formula” for financial success.

When the dust had settled for our thoroughbred operations in 2004, our first full year in the business, we were reasonably optimistic that our six-figure investment would eventually bear fruit. Out of curiosity, we calculated the actual cost of tuition at Harvard University for the four consecutive years beginning in 2004. The cost of this four-year education was a nearly identical six-figure cash outlay. Though most of this investment was breeding-related, and expected, the full extent of our undertaking was beginning to take shape.

As we digested the realities of the business as it all unfolded for us, necessary adjustments became clear. As time went on it began to make sense to us that in order to affect meaningful change in our horse endeavors, we must *first* examine and understand the ramifications of past actions, and *second*, be willing to make the consistent daily choice to manage decisions in accordance with a sound plan for the future.

The fact is, simultaneously participating in *all* aspects of the thoroughbred business can become *very, very* expensive and, if left unattended, can spiral quickly out of control. For the purpose of illustration, here is a summary of our early plunge into the business.

In 2004, we purchased yearlings in Texas, Florida, and Kentucky, participated in breeding partnerships in Oklahoma, managed a four-horse racing stable, offered a two-year-old in-training for sale in a Texas auction, claimed a PA-Bred gelding in Pennsylvania, shipped a mare to California to be bred, and finalized a deal to purchase, move and stand a stallion prospect to Minnesota for the 2005 breeding season.

If these moves seem somewhat aggressive, have a look at our 2005 activity! We tried our hand at *pin-hooking*, that is, offering for sale ten of our previously purchased yearlings as two-year-olds in-training in Louisiana and Texas auctions, and raised our broodmare total to ten, hoping to increase the likelihood of creating a productive first-year crop of runners from our recently purchased stallion, Ballado Chieftan.

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The price of our education was now beginning to expand well beyond any post-graduate work we could have chosen to add to our undergraduate, Ivy-League-like schooling.

The runaway train needed to be derailed, and in its place, a more sensible plan was required. As an entrepreneur, at that time I thought I fully understood the role of risk in creating financial success. It was becoming increasingly clear that risk, at least as I had come to understand it, did not apply comparably in the thoroughbred business.

To stay afloat, basic business success requires that for every dollar of expense incurred, at least one dollar of income plus some factor of profitability must be produced to make the process viable, sustainable, and enjoyable. Budgets and business plans were utilized regularly in our core businesses - why weren't they as effective in our thoroughbred operations? In truth, our budgets and financial projections rarely seemed to match reality, ultimately leading to cash flow issues and a fair measure of frustration.

What were we missing? Where were we going wrong? What could we do to get on track?

Eventually we came to the realization that at least some of our problems seemed to stem from one recurring source, namely *emotion-based decision-making*. We found out that the thoroughbred business stirs impulsive rushes of emotion that can detrimentally lead to "rose-colored" expectations associated with each transaction. These emotions, though admittedly exciting, can also become a deterrent to rational decision-making and must be continually monitored, if financial success is going to be possible in the long run.

Thinking back to July 26, 2003 when our first racehorse, Isaiah, closed strongly to win by a ½-length, sending us into the winner's circle for the first time, it is amazing what a wide range of emotions there are to be experienced in the horse business. We have experienced the "highest" highs, as well as the "lowest" lows in our few short years in the business.

Speaking of Isaiah, he recently won for the 13th time (17 career wins) in 2009 since being claimed from us for \$7,500 in 2004. During that time he earned more than \$60,000 in additional purses while running at several tracks throughout the Midwest. One would think we might be disappointed that we missed out on those 13 trips to the winner's circle - and all those purses. After all, \$60,000 is a significant amount of purse money - isn't it?

It seems as if we may have let a good one slip away, but consider the following. Assume we had kept the horse from July 18, 2004, through his 17th win on April 26, 2009. Further assume we followed the identical race schedule as his new owners had, producing the same results. Here are the financial ramifications, estimated and rounded off to illustrate two important themes found in this book. That is, *wins* don't always lead to profitability; and, one should *never* invest in horses that cannot potentially compete for cost-covering purses.

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It seems a certainty that we indeed *would* have enjoyed our 13 additional trips to the winner's circle with Isaiah - but as this data would demonstrate - the winning would come at much too high a price. As the numbers show, we would have actually lost \$27,500 in five years for the privilege of winning 13 more times; certainly not a sound business investment.

For those who claim to embrace a profit-seeking business motive, knowingly and willingly perpetuating business decisions that involve this class of equine asset would seem unwise. In time, some of these important truths began to make more sense to us. With regard to this healthy mindset, I really appreciate what our second president John Adams once said, "facts are stubborn things; and whatever be our wishes, our inclinations or the dictates of our passions, they cannot alter the state of the facts and evidence." Amen!

Through practice, inquiry, and plain old trial and error, we began to discover better ways to conduct our equine-related business. I want to share these secrets with you.

This resource is designed to assist *anyone* interested in creating financial success in the thoroughbred business by helping them to develop, implement, and maintain a sound, working plan. It is a tool intended to be both a guide for the beginner as well as a helpful reinforcement to the already effective habits of the expert.

There will be an intentional theme woven throughout each section designed mainly to build a foundation for sound, honest horsemanship. I believe this mindset is an important key to any successful thoroughbred program. Believe me, the temptation will be strong to take the less than "high-road view" of the decision making process along the way, especially when faced with mounting bad luck and financial stresses.

Monetary success without integrity is really no success at all. Racehorse management guided by integrity and compassion will *always* pay dividends in the long run.

Without a doubt, there will be days in the horse business when your "boat appears to be taking in water" and it seems questionable whether you'll be able to stay afloat for yet another day amidst the churning currents of misfortune and disappointment. During these times it is important to stay on course, keep the faith, and to continue making sound decisions - preferably consistent with your intentionally designed business plan.

Along the way I will introduce significant axioms, or "Life Preservers", as I'll call them, which will highlight key concepts. Please take particular note of these as we move through the material and establish planning benchmarks. Before we proceed I want to stress one final important point. While I *cannot* guarantee that by following the advice found in this book that your racing program will not be susceptible to down days, what I *can* guarantee is that this resource will be less costly than a Harvard education.

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PICKING YOUR POISON - COMMON NON-RACING OPTIONS

In the introduction, I provided examples of our personal involvement in the thoroughbred industry mainly intended to show that there are many combinations of ways to be involved; truthfully, most can be very gratifying. Through experience, I have found that in our quest for profitability in the horse business, stretching limited financial resources beyond one or at most two key areas of involvement at one time can seriously dilute potential profitability and concentrated focus on each component. Of course, if a thoroughbred program has unlimited resources at its disposal, multi-faceted involvement in the sport can be accomplished, yet not likely to be profitable in the long-term.

One key to success is to start by taking a thoughtful inventory of your financial goals, areas of interest, and operational skills, in advance. Here is a list of common avenues of industry involvement, beyond racing, which a person can become involved.

Breeding with the Intent to Race:

This aspect of the game is by far the most challenging and risk-laden. The main obstacle is the incredible amount of time it takes from the planning of the mating to when the foal finally makes it to the races. The minimum timeframe is 4+ years from mating to racing. If the foal doesn't make the races as a 2-year-old because of immaturity, injury, or other issues - it can take even longer.

This timeframe is a key consideration, somewhat because most people are impatient, but mainly because of the inescapable negative cash flow during the four-to-five non-racing, preparation years. The problem is not difficult to understand. Simply put, there is *zero* income and *all* expense during this period. With boarding rates ranging from \$15 to \$25/day for both mare and foal, boarding costs alone for both can easily exceed \$20,000 (this total does not even take into account the cost of the stud fee) by the time the foal goes off to training; this racing stable already has a considerable financial deficit to overcome. Of course, if the breeder has his or her own facility to care for the mare and foal until the racing years, the prospect of breeding to race becomes a better investment.

In spite of these risks, there are few experiences more gratifying than seeing a foal from a mating you planned, nurtured and paid for, in the winner's circle wearing your stable's racing colors. To ensure full enjoyment in this endeavor, it is essential that realistic acknowledgement of the real costs involved be taken into account, in advance.

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Breeding with the Intent to Sell into the Commercial Market:

Broodmare ownership for the purposes of selling, either at auction or on the private market, is also time-consuming and risky. The potential for income streams comes much earlier in the process than with breeding for racing. Options for marketing your mare and foal are varied as you can sell a pregnant mare at auction, oftentimes within six months from the breeding date. There are also auctions for open broodmares, weanlings, 2-year-olds, horses-of-all-ages and stallion prospects throughout the year, nation-wide. Of course, horses also sell each day on the private market, especially when a broad network is developed, and more prospective buyers become available to purchase from your program.

Some of the main difficulties involved with breeding for the commercial market include: trying to accurately predict the needs of an ever-evolving marketplace, dealing with the financial ramifications of foal mortality issues, or individuals who otherwise aren't marketable as athletes, and a whole host of other economic issues, most of which are almost entirely tied to factors beyond your reasonable control. Other costs include the high cost of sale preparation, veterinary work, and transportation costs.

Still, many experienced breeders make a comfortable living breeding for and selling to the commercial thoroughbred market and it cannot be completely dismissed as a viable option for profitability, especially for those who possess the interest and expertise, and of course, the financial wherewithal to sustain operations.

Breeding - Stallion Ownership:

This aspect of the business can be extremely lucrative, but is also highly capital intensive. Many top stallion outfits around the world are willing to invest millions in a top-producing stallion. Why? In this day of large stallion books (many top studs covering as many as 200 mares per season), a proven and productive stallion can be a highly profitable long-term investment for his owners.

Consider the recently pensioned (retired from stallion duty) Storm Cat. In his prime years of fertility and popularity, he was able to cover more than 100 mares per year - at a price of \$500,000 per live foal! Even at a 65-70% live foal rate, you can see that this stallion was a revenue-producer for his connections. However, most stallions, despite stellar racing careers, often fail at stud and are soon delegated to lesser regional markets where their owners struggle to grind out meager levels of profitability.

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Pin-hooking - The Art of Auction Buy and Re-sell:

As previously mentioned, pin-hooking is simply buying an unraced horse, caring for and training that individual, then re-selling at a later date, hoping for a profit. I think of this process as an art because it is most lucrative for professionals with a honed eye for the future potential of an immature thoroughbred. The most common pin-hooking platform is buying a weanling and re-selling as a yearling (usually an 8 to 11 month turn-around), or buying a yearling and selling as a 2-year-old in training (usually a 6 to 8 month turn-around).

This aspect of horse ownership is highly speculative and shares many of the same risks described above. Anyone who understands the process, possesses an eye for spotting potential talent in young horses, and has the capital to invest, can succeed.

THE RACING PRODUCT - SEPARATING BY CLASS

Next, let's examine the basic structure of my preferred equine investment - the racing product. Thoroughbreds are entered to compete against one another in five main categories, each with purse levels commensurate with speed and racing ability. These levels are simply referred to as *class*. A ranking of horses/types from highest to lowest quality are: (1) graded stakes, (2) stakes, (3) allowance, (4) maiden, and (5) claiming races.

Each category is further broken down by degrees of class, either indicated by larger purse money, as is the case with graded stakes, stakes, allowance, and some maiden races, or claiming price, as is the case with some maiden races and all claiming races. Races in all five categories are further separated by sex. Here are the national percentages by number of races (Table 1.1) and by purse (Table 1.2).¹

(Table 1.1 - Percentage by Number of Races)

Race Type	% Of Races By Number
Stakes (includes graded)	5
Allowance	28
Maiden	14
Claiming	54

(Table 1.2 - Percentage of Purse \$ by Class)

Race Type	% Of Purse By Class
Stakes (includes graded)	25
Allowance	40
Maiden	15
Claiming	20

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These percentages allow us to form some initial conclusions about where, and to which types of horses total purse money is distributed. Stakes and allowance horses, though their runners comprise only 33% of all races run, command nearly 65% of total purse distributions. It follows logically that there is only 35% purse money available for the remaining 67% of races run, namely the runners who make up the maiden and claiming-class races.

This analysis shows that though there are fewer opportunities available for the high-end horses, these opportunities are more lucrative, and there are more frequent opportunities available for the lower-end of racing, though purse money is less per race. These generalities, though interesting, do not properly address the actual probabilities of profitability within each category; thus leaving us to ask the question - what type of racehorse is *most* likely to bring profit, while at the same time minimizing risk? We will discuss this at length later.

What these percentages do provide is a logical framework that works to ensure the integrity and to sustain economic equilibrium for both the high and low ends of the business. They do this by providing disincentive for owners of top horses to enter in races below their class and also for owners of low-class horses from entering in races above the level with which they can be competitive on a day-to-day basis. In the next section we will discuss this self-regulating equilibrium in greater detail and expand upon the best regulator of common sense in the business - the claiming race.