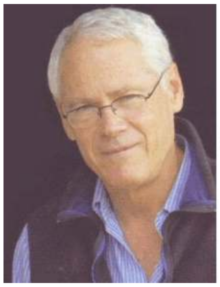

op/ed
by rob whiteley

STUD FEES AND BREEDER PROFITABILITY

Part Two

Why stud fees need to be slashed. A few stud fees for 2011 have already been announced, and so far it looks like business as usual, even though business as usual is a disaster. We cannot ignore the math and go forward with "blinkers on" when the best thing that can be said about this year's horse market is that it is not in free fall compared to the previous year. We have not yet found bottom. Meanwhile, farm owners in Kentucky continue to go out of business on a regular basis, and mare owners who breed to sell are an endangered species.

Increasingly heavy losses in 2008, 2009, and 2010, the reluctance of banks to lend money, the abandonment of the industry by state legislators, and the resistance of suppliers and service providers to lower their fees and prices create a quadruple whammy for most breeders who raise foals and yearlings for sale at auction. Everyone in Lexington is in survival mode.

Harsher pain is on the way. Many more Kentucky breeders who do not have wealth outside of the horse business will go under in the next two years because foals of 2010 and current in-utero foals were bred on the high-priced stud fees of 2009 and 2010. After five consecutive years of cumulative losses, only a handful of commercial breeders who somehow manage to avoid a dependency on bank financing and who are lucky enough to sell several "break out" horses will be able to keep on doing what they do into 2013.

Going forward. Given this bleak scenario, if stallion owners (and all other service providers) want to increase their clientele and grow their revenue in the future, they need to set fees that are in line with current market realities. They cannot rely solely on mostly absentee wealthy mare owners who breed to race or breed to sell with the option of racing, especially as the overall business model for racing is also in shambles.

In addition to establishing realistic stud fees that reflect the auction market, new marketing concepts need to be developed that help sustain commercial breeders and allow them to stay in the game. Completely new ways of doing business and developing better customer relations need to be established that can provide a win-win outcome for all participants in the production chain.

The need for new stud fee and stallion access models. When stallion owners collectively view breeders as true partners in making their stallions, it will be a better day in the Bluegrass.

To this point, breeders have generally been taken for granted and have been treated more like an ATM than a member of the team. In addition to paying high fees for the relatively small number of "fashionable" stallions, breeders often have difficulty breeding back to the same stallion if a stud fee rises or if the stallion happens to become the flavor of the month. And if the stallion owner sells the stallion out of the country or banishes him to a regional market while two years of produce sit in the pipeline, the breeder is automatically thrown under the bus without compensation.

It's also a strange practice that requires breeders to sign stallion contracts when they don't know what they're signing. For starters, contracts should specify the maximum number of mares that will be bred to the stallion in a given season.

Excessively large stallion books may maximize owners' revenue in the moment, but large numbers of foals by a sire translate into increased competition for breeders at the sales, a lower sale average for the sire, and a reduced return on investment for the breeder two and a half years later. Furthermore, excessively large books cause some mares to miss an optimal breeding or to miss a breeding altogether, pushing the mare later into the season and at times causing them to be empty for the year. (An empty year costs the mare owner from $15,000 to $50,000+ in fixed and variable costs, depending on the value of the mare, and creates a hole on the catalog page). Thus, contracts should specify some form of compensation to the breeder when a mare is bumped because the semen seller cannot present the stallion when needed as a result of selling too many seasons. It's like Delta Airlines selling 185 seats on a plane that can accommodate 120.

Perhaps in the nick of time … some new thinking. Hope may be on the way, if some recent initiatives gain traction. Two very savvy businessmen who were hugely successful outside of the horse business have expressed a clear appreciation for the notion of breeders as partners. They understand the importance of shared risk while rewarding customers who help them become successful. If the perspective that these men possess is adopted and expanded across the ranks of stallion owners, it will strengthen the overall breeding community.

B. Wayne Hughes built a 17-billion dollar company and Rick Porter developed the multi-franchise Porter Automotive Group by knowing how to treat their customers in the best way, and by devising strategies to keep those customers coming back. Both men fully comprehend how building a consistently successful business (one that maintains itself in good times and bad) depends on the fair and respectful way customers are treated, and on the loyalty of its customer base. Therefore, it is not surprising that both men have taken a long-range point of view and designed opportunities for breeders to participate in the front end of a stallion's career while providing continuing access to that stallion at no further expense, should the stallion hit.

As B. Wayne Hughes states in his Spendthrift Farm 'Share the Upside' video, much of "the gambling is done by the breeder…[and] if the stallion is successful, the people that actually made the stallion successful can't breed to him or they have to pay increased fees every year. It's a little difficult to know that you made the stallion successful, but you're not participating in the upside of the stallion." These words and this progressive mind-set represent a sea-change from the historical attitude toward the breeder, and the embedded concepts could be implemented in countless win-win ways.

These initiatives join a handful of other promotions that have been designed to assist, "protect," or reward the customer. Darby Dan's "Profit Protection" plan, for example, pays the first x amount of proceeds to the breeder before any money is due for the stud fee. Darley has "Pay out of proceeds with forgiveness" which helps with carrying charges by deferring payment until sale time and protects the breeder from liability for the full amount of the fee if the sales price falls short. (This plan only works, however, if the stud fees are not set too high for the market that follows two and a half years later). A few other incentive plans include cash payments and complimentary breed-back offers when major stakes winners are produced. If breeders who breed as a business are to be kept in the game, this kind of thinking needs to become mainstream and further developed.

Meanwhile, stallion owners who control the relatively small number of "commercial" stallions and who enjoy a very favorable supply and demand status for the "go-to" sires will be wise to design strategies that better serve their customers and that keep both the wealthy players and the hands-on working people in the game. In short, this means pricing stallions and limiting the size of their books so that breeders have a fair shot at profitability.

What is a fair chance at profitability? Each reader will have their own notion of what is a fair shot at being profitable. My belief is that the fees of all service providers, including stud fees, should be adjusted to give the breeder a 50-50 chance of breaking even. No one deserves a hand out or a free ride. Breeders gamble willingly with a free will and the hope of making it through to the next year in order to start over and do it again. The odds of a coin flip seem fair enough.

To explore this concept, I first examined 2010 yearling sales data for the top 30 active sales sires with 20 or more through the ring by their median average through September, including RNAs. I chose the median average instead of the mean average because it is the best measure of group performance, as the median is the mid-point in a distribution (i.e., 50% of the prices would be higher and 50% would be lower). The more commonly reported mean average is determined by adding up all of the prices and dividing by the number of horses. Therefore, the mean average can be a skewed measure of group performance when there is huge break-out horse or when phony sales are manipulated by stallion managers to inflate the appearance of a stallion's performance.

Secondly, I calculated production costs and determined what each 2011 stud fees needs to be for the top 30 sales sires, based on 2010 results, in order to give the breeder who sells at auction a 50-50 chance of breaking even. Thus, the following top American "commercial" stallions (all of whom stand in or about Lexington, Kentucky) are ranked from highest and in descending order according to median sales averages in 2010. Numbers of foals in the 2009 crop are also included to give the reader a rough idea about the size of each stallion's book in 2008.

The final column lists the calculated stud fee that would give breeders a 50-50 chance of breaking even in two and a half years after all costs are factored in, assuming that current market conditions and stallion performance remain constant. (The cost formula can be found in this researcher's TDN Op/Ed, October 8, 2010).

The reader should keep in mind that the calculations of these stud fees for 2011 are based on sales results in 2010 which may or may not be similar to results in 2013 when the yearlings go to market. It should also be noted that several popular young stallions with a number of current stakes horses were bred to so-called "lesser" mares and on lower fees in 2008, and their 2010 sales results and current rank are reduced accordingly. Medaglia d'Oro, Speightstown, and Tapit (who are in the top 30) as well as Afleet Alex, Candy Ride and Congrats (whose median sale averages did not make the cut-off of $45,000) are six such examples. Therefore, a good case could be made for adjusting fees for these emerging stallions upward from the figures in the Table below.

2011 STUD FEES REQUIRED FOR BREEDERS TO HAVE A 50-50 CHANCE AT BREAKING EVEN

(based on yearling sales results in 2010)

	STALLION	'09 foals	ylgs thru ring	'10 Sales Median	'10 fee	'11 fee for 50-50 break even chance
1	AP INDY	62	28	$295,000	$150,000	$140,000
2	DISTORTED HUMOR	88	29	$200,000	$100,000	$80,000
	SMART STRIKE	114	40	$200,000	$75,000	$80,000
4	BERNARDINI	110	44	$160,000	$60,000	$60,000
5	UNBRIDLED'S SONG	97	64	$145,000	$100,000	$50,000
6	GIANT'S CAUSEWAY	146	73	$135,000	$100,000	$45,000
7	STREET CRY	153	42	$120,000	$150,000	$40,000
	STREET SENSE	116	57	$120,000	$50,000	$40,000
9	MR. GREELEY	126	80	$115,000	$50,000	$35,000
	PULPIT	71	36	$110,000	$60,000	$35,000
11	EMPIRE MAKER	113	52	$105,000	$50,000	$32,500
	TIZNOW	115	70	$105,000	$75,000	$32,500
13	MEDAGLIA d'ORO	87	57	$100,000	$100,000	$30,000
	INDIAN CHARLIE	85	56	$95,000	$70,000	$30,000
	MALIBU MOON	122	81	$95,000	$40,000	$30,000
16	HARD SPUN	143	87	$80,000	$35,000	$25,000
17	ELUSIVE QUALITY	117	72	$70,000	$75,000	$20,000
	TAPIT	80	43	$70,000	$50,000	$20,000
19	SPEIGHTSTOWN	87	57	$65,000	$35,000	$20,000
20	AWESOME AGAIN	102	50	$60,000	$50,000	$17,500
	ROCK HARD TEN	77	43	$60,000	$25,000	$17,500
22	CORINTHIAN	135	89	$55,000	$30,000	$17,500
	STORMY ATLANTIC	111	50	$55,000	$35,000	$17,500
24	FIRST SAMURAI	75	48	$52,500	$30,000	$15,000
	ARCH	83	42	$52,500	$25,000	$15,000
26	LEMON DROP KID	115	65	$50,000	$35,000	$15,000
	MORE THAN READY	90	54	$50,000	$25,000	$15,000
	TALE OF THE CAT	113	57	$50,000	$30,000	$15,000
29	ANY GIVEN SATURDAY	93	47	$45,000	$25,000	$12,500
	MINESHAFT	51	27	$45,000	$20,000	$12,500

** Stallions (with 20 or more sales yearlings) that do not appear on this list would warrant a stud fee of less than $12,500 in order for commercial breeders to have a 50-50 shot at profitability.*

The reality and the hope. Actually, these data provide the truth, which should not be confused with reality, and readers can make of it what they choose. The reality of the sales scene is that it is driven by perception and not by fact or truth, and stallion owners will largely continue to price their stallions according to what they want and according to what they think they can get from people in search of "the big horse." This of course, is business as usual, yet it is business as usual that has brought us to our knees.

I hope for more. We can make this business better, one decision at a time. The immediate problem that we must address and solve is that we have two very different groups of constituents; one relatively wealthy group that participates as "investors" in order to be part of the sales scene or racing, and another group of hands-on horsemen who attempt to make it through a mine field of challenges in order to be around the horses that they love 24/7. The first group will pay whatever in order to get into the winner's circle and be a part of an exciting source of entertainment, social engagement, and pleasure. The second group can only pay forward what comes back to them, as they love the life they live and seek to live the life they love. More than ever, we need to innovate and find a way so that all can thrive. If we can be that wise and devise more creative, customer-friendly strategies, it will actually benefit service providers and help preserve the greatest sport on earth, as well as all the people that get up each morning to make it possible.

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