

Taking a Calculated Risk

Carl Icahn has brought his Wall Street philosophy of buying low and selling high to the commercial breeding industry



Carl Icahn leads undefeated Meadow Star down Belmont Park's Victory Lane after the Matron Stakes (G1).

by David L. Heckerman

AS Carl C. Icahn tells it, the horse business is primarily business. Not that there isn't a great deal of fun in watching an undefeated filly like Meadow Star carry one's colors into the Breeders' Cup. It's just that, in Icahn's eyes, the real challenge and accomplishment in the Thoroughbred industry lie elsewhere.

"I get enjoyment out of building a business that makes a profit," Icahn said in early October. "My goal with Thoroughbreds is to build a successful breeding program that makes a profit every year. Not just once in a while, but every year. If I can do that and have fun, too, I will get a great deal of satisfaction out of owning Thoroughbreds."

In pursuit of profits and his own brand of fun, the 54-year-old Wall Street financier, arbitrager, takeover specialist, corporate executive, and philanthropist has developed a business plan for his Thoroughbred enterprises that borrows heavily from strategies he has employed in the world of finance.

Though Meadow Star has drawn attention to his racing stable this year, it is Icahn's commercial breeding program that forms the bulk of his Thoroughbred operation. The racing stable numbers only ten, and all are fillies on the way to becoming broodmares. The breeding program, on the other hand, includes 90 mares, as well as significant interests in seven stallions.

The entire program, at least as it has developed in the past two years, is geared toward the ancient Wall Street strategy of buying low and selling high, based on a calculated notion of where the Thoroughbred market is and where it is headed.

"I'm not a gambler. I'm a risk-taker, and I always go about these things in a very calculated way," Icahn told *Fortune* magazine in March of 1985, by way of explaining his operations on Wall Street. His explanations of his strategy in Thoroughbred breeding bear numerous parallels.

"We buy horses according to very strict disciplines," Icahn told *Thoroughbred Times*. "The way we establish controls, it's almost like arbitrage. The way I do the theory is, if we buy broodmares right, even if we sell foals at lower prices than projected, we'll still break even, after considering the

cost of horse expenses and everything."

In practice in the late 1980s and early 1990s, this has come to mean shopping for broodmares at significantly less than fair market value; assuming strong positions in promising stallions with considerable upside potential; controlling expenses rigorously at every step along the way; taking full advantage of depreciation charges available from purchases of broodmares and stallion shares; and producing yearlings at relatively low costs who can still qualify for the select sales.

"Before we buy broodmares, we rate the prospects in four categories—racing record, produce record, pedigree, and conformation," Icahn said. "I leave conformation questions to the experts, but I can work the rest of it out on my own. We don't buy anything unless it sells for 50% or less of the value we put on it. We look for the ones that fall through the cracks, and we have found several of them in the last two years. Discipline is the key to the whole thing. If we buy right, we figure we're going to come out right."

"One of the real flaws in the Thoroughbred business is that too many people think they're going to figure the key to breeding a good horse, rather than trying to find out how to buy at value. The real thing you can figure out is the risk-reward ratio. That's what I do in my other businesses, and that's what I'm trying to do in the horse business."

PROPER calculation of risk and reward, particularly during the vast expansion of America's capital markets in the 1980s, has kept Carl Icahn's name in the headlines of financial journals for much of the past ten years.

In December, 1987, at a time when he was seeking to forge a settlement in the landmark Pennzoil-Texaco antitrust lawsuit, the *Wall Street Journal* offered this sketch of Icahn: "New York investor, chairman of Trans World Airlines, Inc. Former arbitrageur turned takeover artist in late 1970s, famed in battles with Phillips Petroleum and USX. Poised for huge profits on 2% stakes in Pennzoil and 12% holding in Texaco."

In October, 1989, *Forbes* magazine presented the following update in its annual chronicle of America's wealthiest persons:

"Carl C. Icahn, Bedford, N.Y. Married, two children. Schoolteacher's son from NYC's Queens; studied philosophy at Princeton, spent three years at medical school, then got serious; to Wall Street as broker 1961. . . . Began buying large blocks of stock, then forced management to enhance shareholder value. . . . Denounced as greenmailer by some; but running ACF (builds, leases railcars). Also running TWA. Huge paper gain on USX stake; earned nearly \$500-million on sale of Texaco stock this year. Managements tremble as he inwighs against entrenched executives divorced from shareholder interests. 'No market is generally a very dangerous place, but if you buy when nobody wants them, and sell when everybody wants them, you'll have a decent chance of success.' So says man now worth at least \$1.2-billion."

That was one year ago. This October, *Forbes* has just weighed in with a revised estimate: "With TWA faltering," the magazine commented in its latest thumbnail outline of Icahn, "net worth will require legendary financial wizardry to stay \$1-billion."

Down to his last billion dollars, though he may be, the owner of Meadow Star would still appear to have the wherewithal to support whatever kind of strategy he chooses in Thoroughbred racing and breeding. And the chosen strategy has evolved gradually since Icahn bought his first Thoroughbreds five years ago.

The Thoroughbred world could hardly have missed Icahn's entry, coming as it did at the spectacularly successful dispersal of Newstead Farm in November of 1985. He arrived as a partner of major owner-breeder Peter M. Brant of White Birch Farm, and the two men promptly paid a world-record price of \$7-million for Newstead's grand racehorse Miss Oasana, in foal to Northern Dancer.

They also purchased Newstead's splendid Northern Dancer mare Larida for \$4-million, the highest price ever paid for a broodmare who was not in foal. Before Kentucky's annual round of breeding stock sales was completed that November, Icahn's Foxfield breeding operation had signed sales tickets for four mares for \$15,250,000, and had added a share in Northern Dancer,

Taking a Calculated Risk (cont.)

the formulas on each of the 89 mares and agreed on target prices. From that not-so-short list, 33 purchases were ultimately made.

"Carl brings a brilliant business mind to bear on the strategy for the overall program," Whiteley said. "He informs himself about the business generally and our horses in particular. We discuss all of our purchases in advance, and we review any purchases I have made one-by-one immediately after the sale, typically between 11 p.m. and 2 a.m."

The breeding program is designed to produce select-sale yearlings who carry realistic breeding costs with them into the ring. It is also designed to allow considerable room for appreciation in the value of mares, should something good happen to their pedigrees.

"We have a much better chance of hitting a home run with broodmares than we do with yearlings," Icahn said. "With our disciplines in place, we know we're not going to lose much with the mares, and some of them are going to be worth a lot more than what we paid."

A case in point of which Icahn is particularly proud is the Mr. Prospector mare Propositioning, whom Foxfield purchased for \$110,000 at Keeneland in 1988. The mare assumed a substantially higher value this year, when her two-year-old colt Deposit Ticket emerged as one of the leading juveniles of 1990.

"Propositioning proves the point that our strategy is working more than Meadow Star," Icahn said. "Finding a Meadow Star is luck, but we're going to come up with more mares like Propositioning as we go along."

STALLIONS also play a key role in the Foxfield business plan. Icahn and Whiteley express belief that market conditions make the time right to purchase major positions in unproven stallions at prices that can escalate quickly if the stallions prove successful. They also hope to improve the stallions' chances of success by sending Foxfield's mares to them.

At present, Foxfield owns half-interests in Blushing John, Orygian, and Sunshine Forever and substantial additional interests in Crafty Prospector, Deputy Minister, Gulch, and Private Terms. Only Crafty Prospector and Deputy Minister already have runners at the races.

The stud fee range of the stallions covers the middle and upper-middle levels of the stallion market, from \$15,000 for Crafty Prospector and Private Terms to the \$50,000 fees in 1990 for Deputy Minister and Gulch. Foxfield also breeds to a roster of other horses, including top-of-the-market stallions for the most valuable mares.

Neither Whiteley nor Icahn is any great fan of breeding theories based on pedigree alone—"alchemist's formulas," as Icahn calls them.

"I'm personally not much of a believer in nicka," Whiteley said, "though it only makes

sense to continue looking for success where it already has been found. In general, I think it is easier to explain success in terms of breeding quality to quality, or type to type.

"As commercial breeders, we're well aware of the crosses that have market appeal, and all things being equal, we sometimes make the decision to go with a perceived nick. Fundamentally, though we're more interested in breeding physical qualities to physical qualities in order to produce well-conformed athletes."

The bulk of Foxfield's mares are kept at Trackside Farm near Versailles, Kentucky. The farm is operated by the team of Tor Evans and Pam Clark, with whom Foxfield maintains a management agreement. Evans also consults with Whiteley regularly on the selection of broodmares and yearlings.

One year ago, Icahn purchased 800 acres of Bluegrass farmland from fellow entrepreneur and breeder Allen E. Paulson. The land, once part of Pin Oak Stud, near Versailles, was acquired in the transaction that saw Icahn buy a half-interest in Blushing John, who raced for Paulson and stands at stud at Paulson's nearby Brookside Farm. There are no immediate plans to develop Icahn's farmland.

The goal with many of the mares purchased in the past two years is to produce yearlings who would yield profits if sold for prices from \$125,000 to \$200,000, a range for select yearlings where Whiteley expects demand to be particularly strong in the immediate future.

Whiteley sketches the cost picture in following way:

"We think a \$200,000 mare warrants a stud fee of \$35,000 to \$50,000. If we paid \$200,000 for a middle-aged mare with, say, six years of useful life left, we would have a cost-basis of approximately \$35,000 per foal. Add to that the maintenance cost of the mare while the foal is in utero, the maintenance cost of the foal, the maintenance cost of a yearling, the cost of sales preparation, plus the cost of the money and the sales commission, and the total production costs would be about \$100,000. That would be the break-even point—about three times the stud fee—and our target for the yearling might be \$150,000."

In 1990, Foxfield offered 13 yearlings at select sales and sold ten for gross revenue of \$1,940,000 and an average price of \$194,000.

In 1990, Foxfield offered 13 yearlings at select sales and sold ten for gross revenue of \$1,940,000 and an average price of \$194,000.

"We are purists when it comes to our commercial operation," Whiteley said. "Every foal that is salable will be offered at reasonable prices. Except for an occasional private sale, we will take every yearling that qualifies to auction and set realistic reserves."

"Typically, we set our reserves at approximately two-thirds of our conservative estimate of what the horse is worth. If we don't get our reserve, we'll take the yearling home

for a private or two-year-old sale, or if we have to, we'll train it ourselves and hope to get lucky."

Whiteley, the analyst, working for Icahn, the strategist, also has a prepared statement about the keys to success in the Thoroughbred business.

It reads: "Have short-term objectives that fit a long-term plan. Have adequate capitalization to see the plan through. Put the very best people in place at all levels who are experienced, competent, and reliable."

"Understand and appreciate the symbiotic relationship between breeding and racing, and be able to assess racing performance and its implications for a commercial breeding program. Breed to get an athletic, good individual first, and a catalog page second—but go for both."

"Treat others fairly and the way you would want to be treated yourself. Work very hard to position yourself to good luck can run over you."

Thus positioned, Carl Icahn has found himself in the path of Meadow Star and Propositioning in the summer and fall of 1990. His past performances on other racecourses suggest that his calculated strategy of Thoroughbred risk-taking may lead to similar rewards in future years. ■

David L. Heckerman is senior editor of Thoroughbred Times.
