

Equine Business Year in Review – 2004 is published by Dean, Dorton & Ford's Equine Industry Group. We hope you find the information we present regarding thoroughbreds to be interesting and helpful. We welcome your feedback.

Located in the heart of central Kentucky, known for its world-class horse farms, racing, and sales, Dean, Dorton & Ford has provided accounting, tax, and business consulting services to the horse industry since our inception in 1979. Our clients cover a broad spectrum of organizations involved in the horse industry, from small boarding farms to large multi-departmental farms involved in boarding, breeding, selling, stallion management, and crop production; from racing stables to a racetrack; from bloodstock agents to equine veterinary firms to equine insurance agencies; and from industry associations to industry publications. Not all of our clients are based in central Kentucky; horse industry clients from other parts of the country and from outside the United States also gain comfort by having our industry specialists work with them.

As a firm, we endeavor to know the business of horses, not just accounting and tax rules relating to the industry. We accomplish this in a number of ways, including meeting periodically, often with outside experts, to discuss business topics of interest in the industry; by reading industry periodicals; by studying the abundance of statistical data available regarding different measures of industry performance; and most usefully, by working with our clients in the industry on their business matters.

We perform a variety of services for our clients involved in the equine industry and welcome inquiries, whether from new participants in the industry who want assistance in properly structuring and administering their stables or farms, or from long-time industry participants seeking to improve the performance and administration of their equine operations. Members of our Equine Industry Group will be pleased to answer any questions you may have. Please call any of the following: Doug Dean, Richard Dorton, Joe Ford, Martha Jones, Leigh McKee, or Emily Carpenter.

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Dean, Dorton & Ford, P.S.C. - Equine Industry Group Services

Accounting

- Directly performing many accounting, payroll, and clerical functions for smaller enterprises.
- Designing and implementing farm accounting and management information systems.

Business Consulting

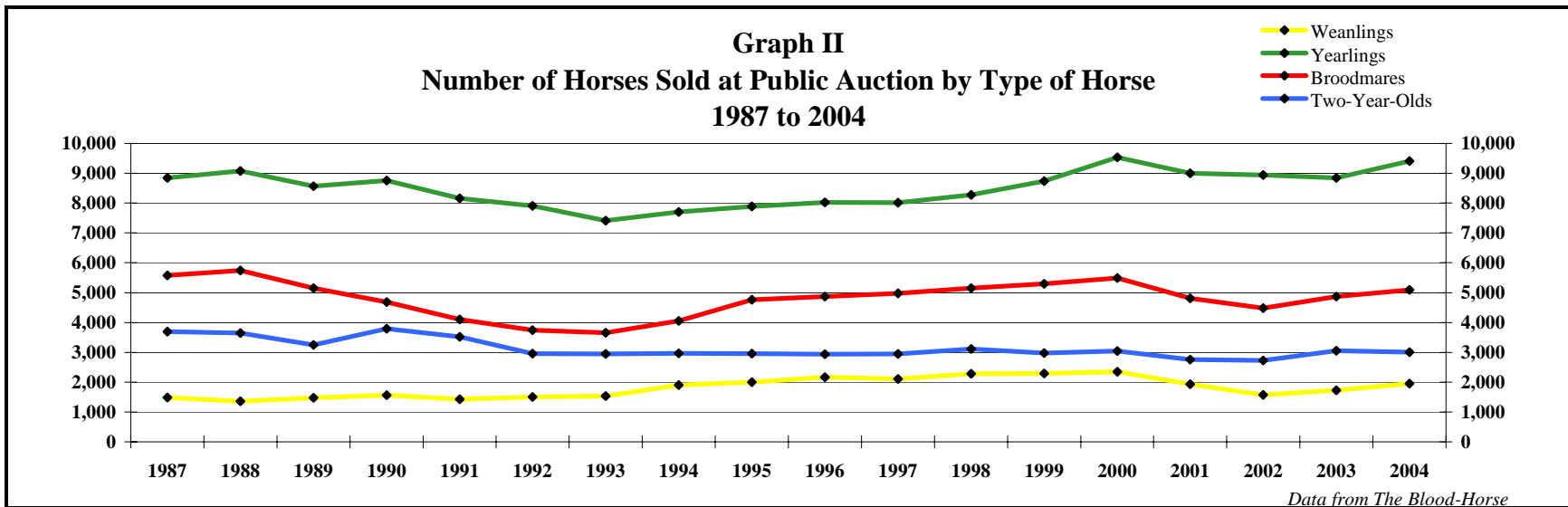
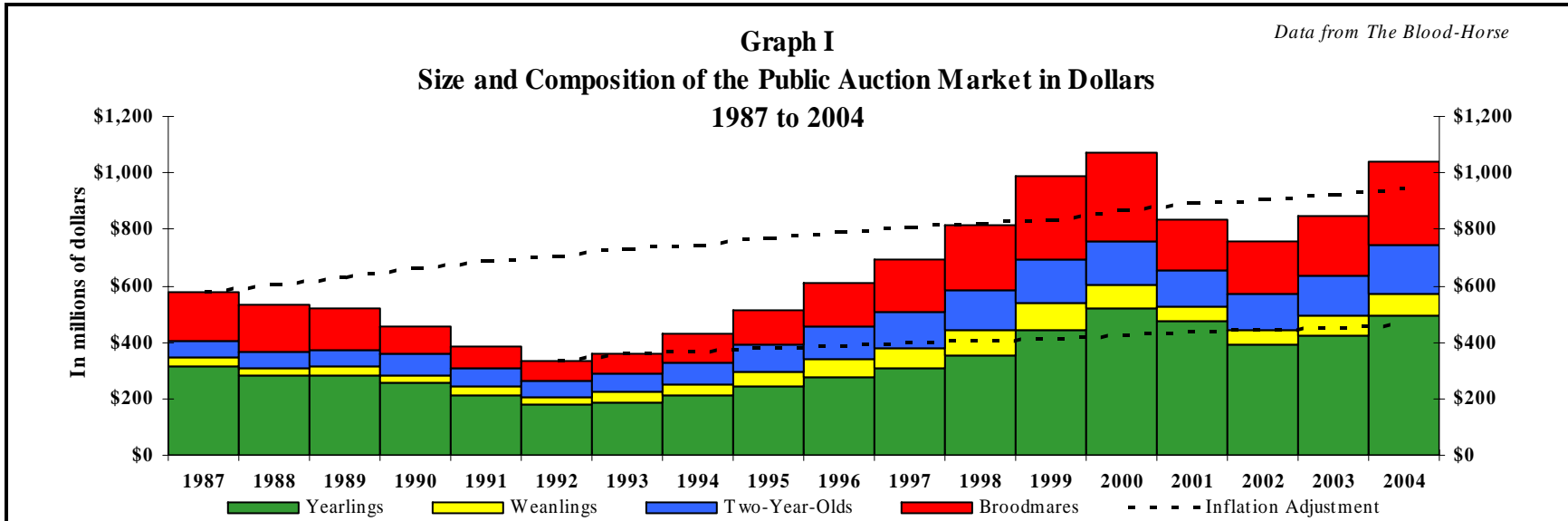
- Developing strategies to use the optimum forms of organization in which to conduct horse and farm businesses.
- Developing financial and business plans for farms, breeding operations, and racing stables.
- Financial analysis of stallion prospects.
- Designing and implementing retirement plan and other employee benefit programs.

Tax

- Developing strategies to make maximum use of potential tax losses.
- Avoiding exposure to the hobby loss rules.
- Structuring transactions to avoid or minimize sales and use taxes.
- Avoiding or managing the potential impact of the passive activity loss rules.
- Using current and deferred trades of horses and farms to avoid or postpone income taxes.
- Using the involuntary conversion tax rules to defer income taxes on insurance recoveries related to horse and farm casualties.
- Estate planning designed to use special use valuation and family farm conservation incentives, family limited partnership strategies, and deferred tax payments.
- Handling multi-state tax allocations.
- Helping foreign owners and breeders to minimize exposure to U.S. taxes and comply with filing requirements.
- Developing tax accounting systems to comply, where required, with rules requiring capitalization of preproductive period costs.
- Representing clients with federal and state tax audits.
- Taking advantage of unique tax depreciation rules.

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Commentary on Graphs I and II

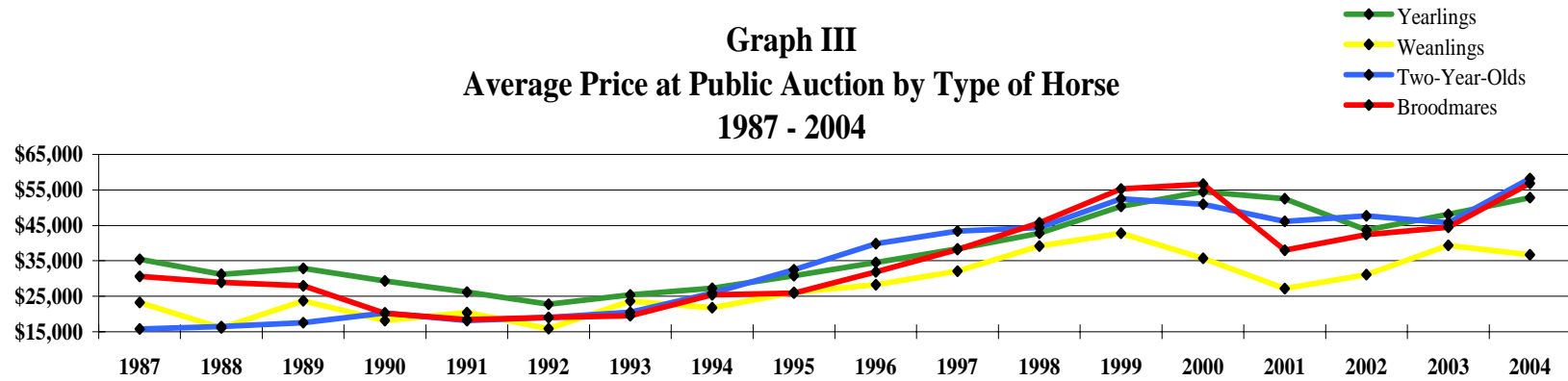
- Our 18-year view of the aggregate amount of dollars involved in North American thoroughbred public auction sales readily shows the long, steady decline from 1987 to 1992, followed by an even longer and more pronounced increase from 1992 to 2000. 2003 sales, even with reduced numbers of yearlings due to MRLS, reversed the downward trend experienced in 2001 and 2002. 2004 sales dollars increased again, and 2004 was the first time since 2000 that sales dollars have exceeded the inflation-adjusted dollar value from 1987.
- Sales by category (in dollars) as a percentage of the total auction market are as follows in recent years:

	1999	2000	2001	2002	2003	2004
Weanlings	9.9%	7.8%	6.3%	6.5%	8.0%	6.9%
Yearlings	44.6%	48.6%	56.6%	51.4%	50.1%	48.9%
Two-Year-Olds	15.9%	14.5%	15.2%	17.1%	16.5%	16.5%
Broodmares	29.6%	29.1%	21.9%	25.0%	25.4%	28.7%

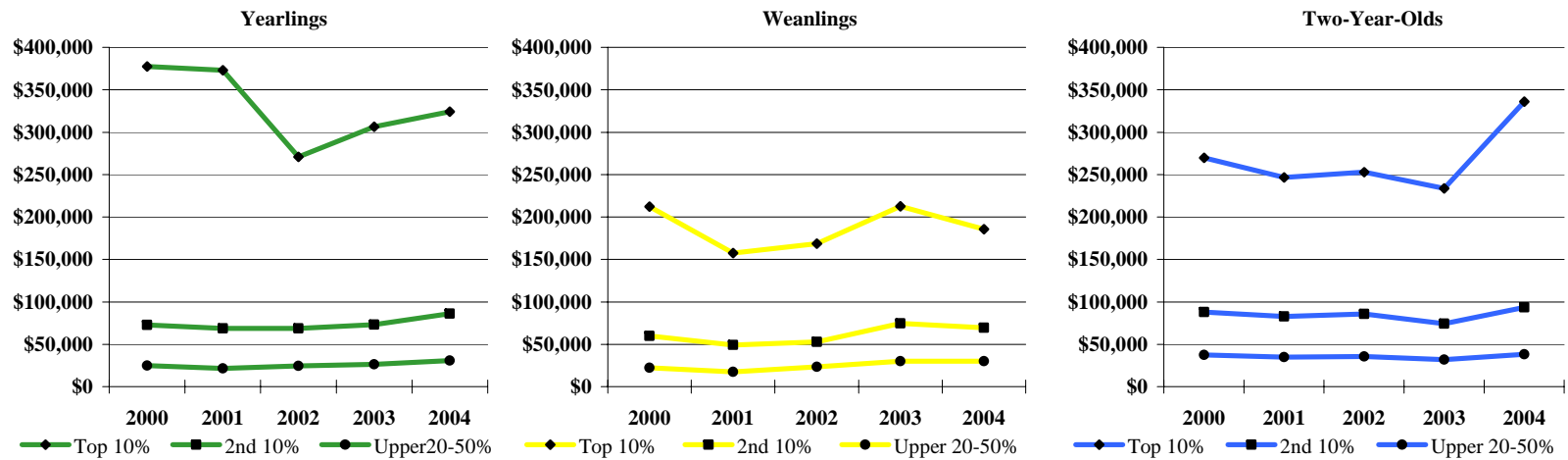
- The total number of horses sold at auction reached its highest level in 2000 (after seven consecutive years of increases), decreased 9% in 2001 and 4% in 2002, then increased 4% in 2003 and 5% in 2004. There were 2004 increases in the number of weanlings (13%), yearlings (6%) and broodmares (5%) sold, while two-year-old numbers decreased 2%.
- 5% of the 2004 North American foal crop sold at public auction as weanlings, and 25% of the 2003 North American foal crop sold at public auction in 2004 as yearlings. The following shows the relationship of these numbers to the four previous years:

	2000	2001	2002	2003	2004
Weanlings	7%	5%	5%	5%	5%
Yearlings	29%	25%	25%	24%	25%

Graph III
Average Price at Public Auction by Type of Horse
1987 - 2004



Graph IV
Average Price by Type of Horse by Decile
2000 to 2004



Data From Auction Review, The Thoroughbred Times

Commentary on Graphs III and IV

- Average prices for yearlings, two-year-olds, and broodmares increased in 2004. Broodmare and yearling average prices continued these increases from 2003, while two-year-old prices rebounded from a decline in 2003. Broodmares and two-year-olds showed the most pronounced increases from 2003 (28% and 27% increases, respectively). Average prices of weanlings decreased 7% after recording sizeable increases in 2002 and 2003.
- After dropping 4% in 2001 and 17% in 2002, average prices of yearlings sold at public auction increased by 10% in 2003 and again in 2004. Note the strength in yearling prices even with the increase in supply in the aftermath of reduced numbers available for sale in 2002 and 2003 as a result of MRLS.
- Note the changes in average prices from 2003 to 2004 in relation to the ages of young racehorse prospects: weanlings down 7%, yearlings up 10%, and two-year-olds up 27%. The nearer the time before a racehorse prospect is expected to compete at the track, the greater the apparent increase in demand.
- Average prices of two-year-olds and broodmares reached their respective peaks in 2004. The yearling average price nearly matched its peak in 2004 (3% short of 2000 average yearling price).
- Graph IV examines the top 50% (by price) of these market segments – yearlings, weanlings, and two-year-olds – over the last five years. The following table shows the ratio by category of the top decile to the second decile in terms of average prices. Note how much more the top decile of prices has been than the second decile – generally from at least three to more than five times, saving weanlings:

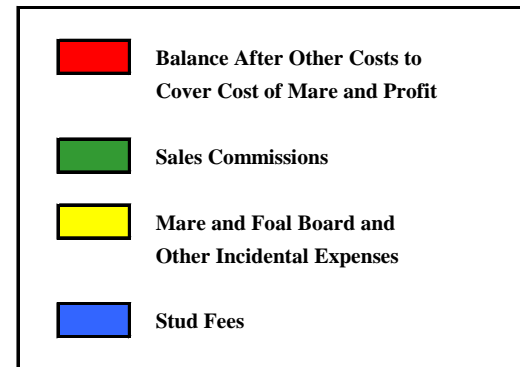
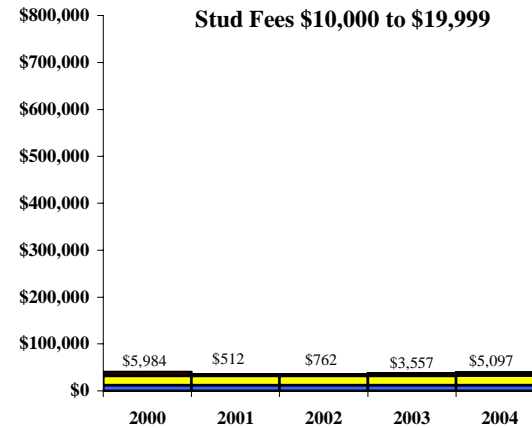
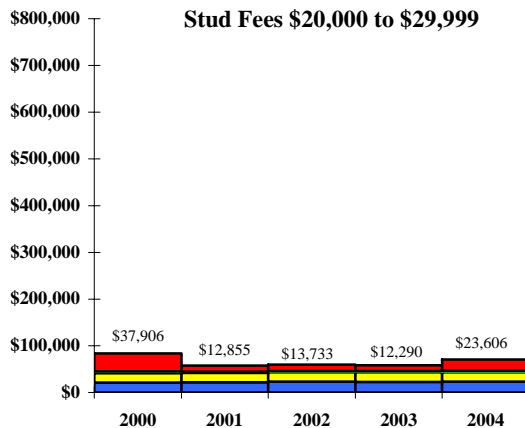
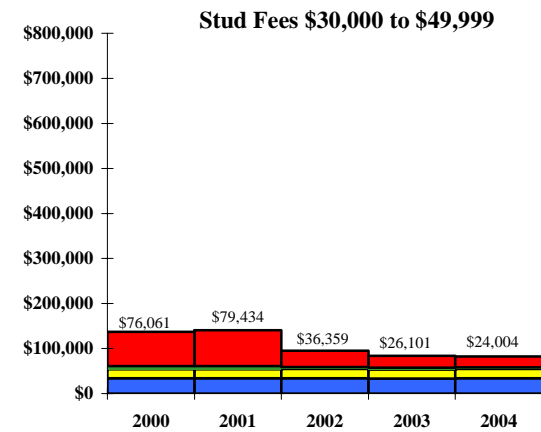
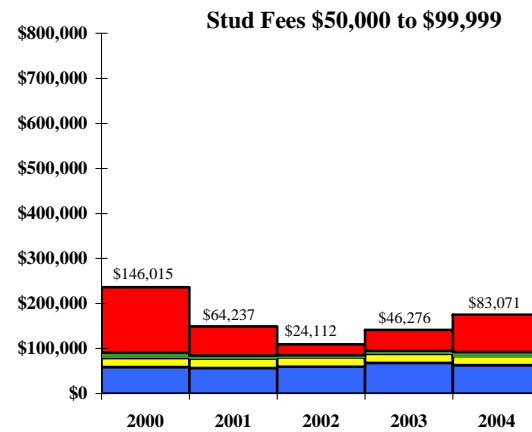
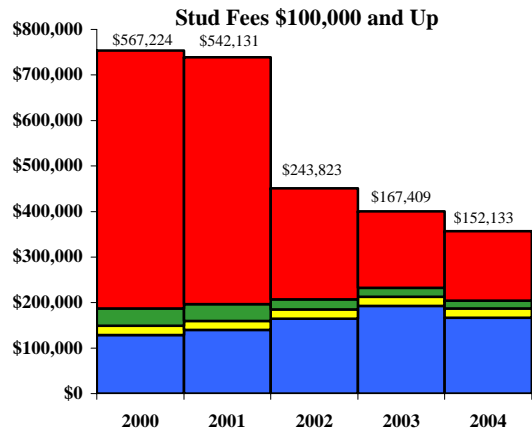
	2000	2001	2002	2003	2004
Yearlings	5.2	5.4	4.0	4.2	3.8
Weanlings	3.5	3.2	3.2	2.8	2.7
Two-Year-Olds	3.1	3.0	3.0	3.1	3.6

- Note that the top decile average yearling price, which experienced a 13% increase in 2003, showed a 6% increase in 2004. The second decile increased 18% and the combined third through fifth deciles increased 17% in 2004. Although not shown, the sixth through tenth deciles each had 2004 increases as well.

- The average price in the top decile for weanlings decreased in 2004 by 13%. The 7% overall average price decrease for 2004 was comprised of decreases in deciles 1 through 4 contrasted with increases in deciles 5 through 10. For 2004 weanling sellers, the lower part of the market was stronger and the upper part weaker than in 2003.
- Average two-year-old prices in the top decile increased 34% in 2004. In fact, average prices in every decile increased by double-digit percentages in 2004.

Note: Dollar figures above bars on bar graphs represent amounts remaining after other costs to cover mare and profit.

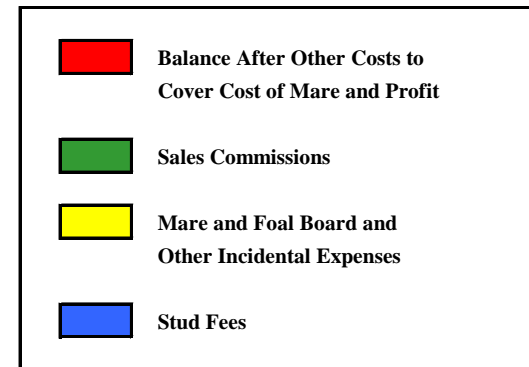
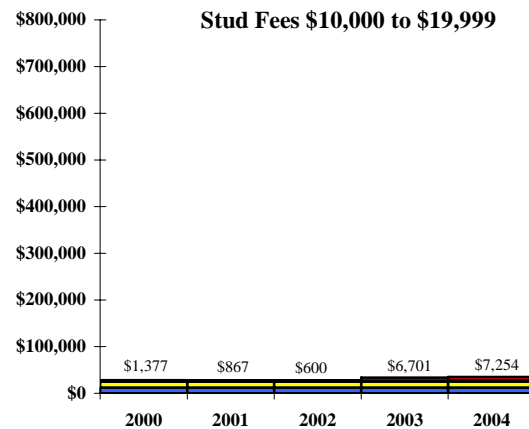
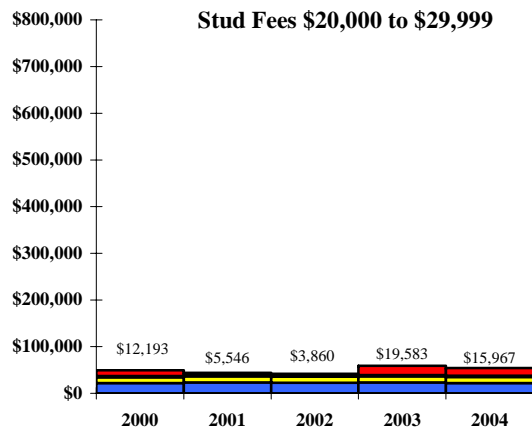
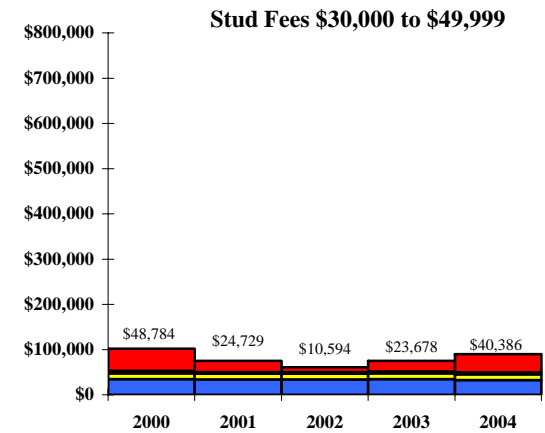
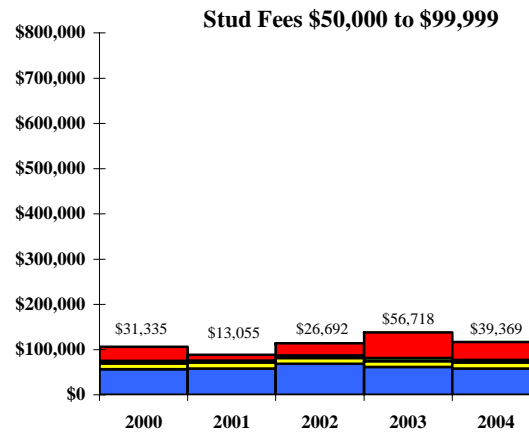
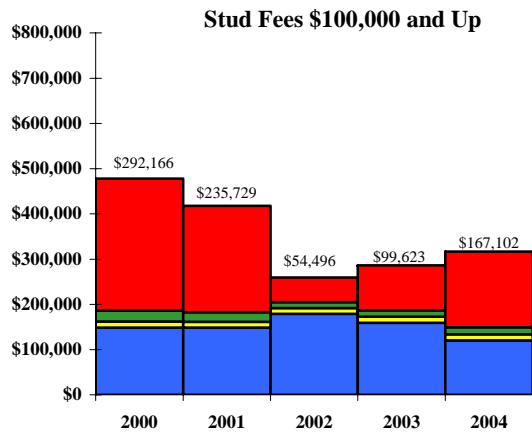
Graph V
Breakdown of Price of Yearling Sales into Cost Components -- Stud Fees, Sales Commissions, and Mare and Foal Board and Incidental Expenses -- Balance Available to Cover Cost of Mare and Profit
YEARLINGS -- By Stud Fee Range
2000 to 2004



Underlying Data from Auction Review, The Thoroughbred Times

Note: Dollar figures above bars on bar graphs represent amounts remaining after other costs to cover mare and profit.

Graph VI
Breakdown of Price of Weanling Sales into Cost Components -- Stud Fees, Sales Commissions, and Mare and Foal Board and Incidental Expenses -- Balance Available to Cover Cost of Mare and Profit
WEANLINGS -- By Stud Fee Range
2000 to 2004



Underlying Data from Auction Review, The Thoroughbred Times

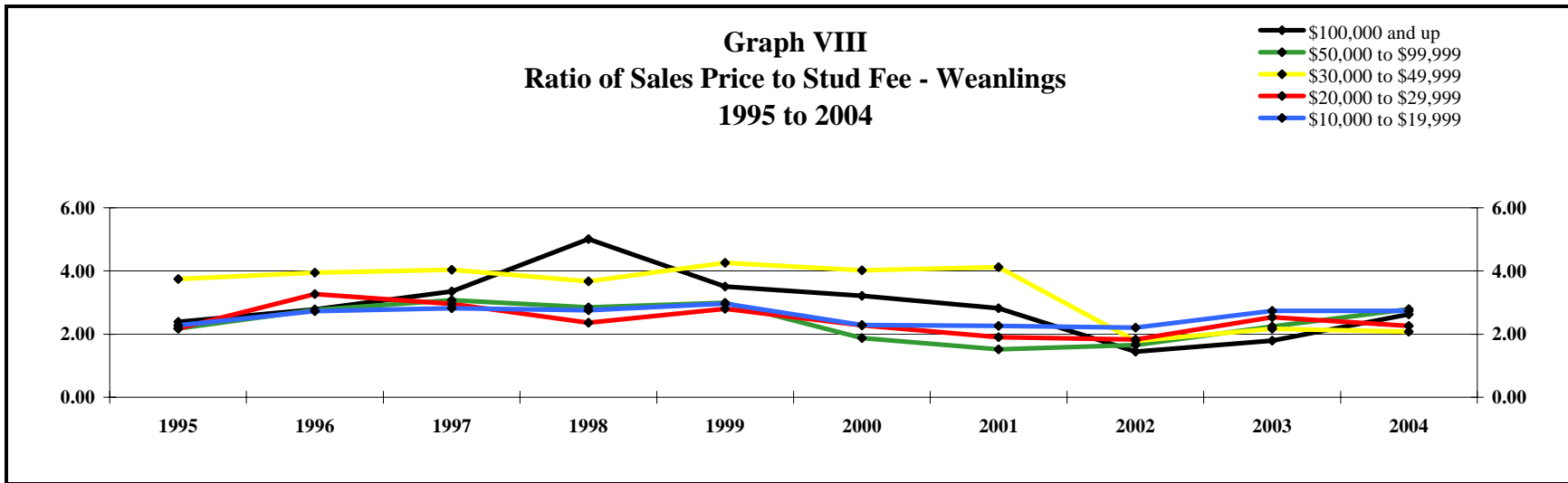
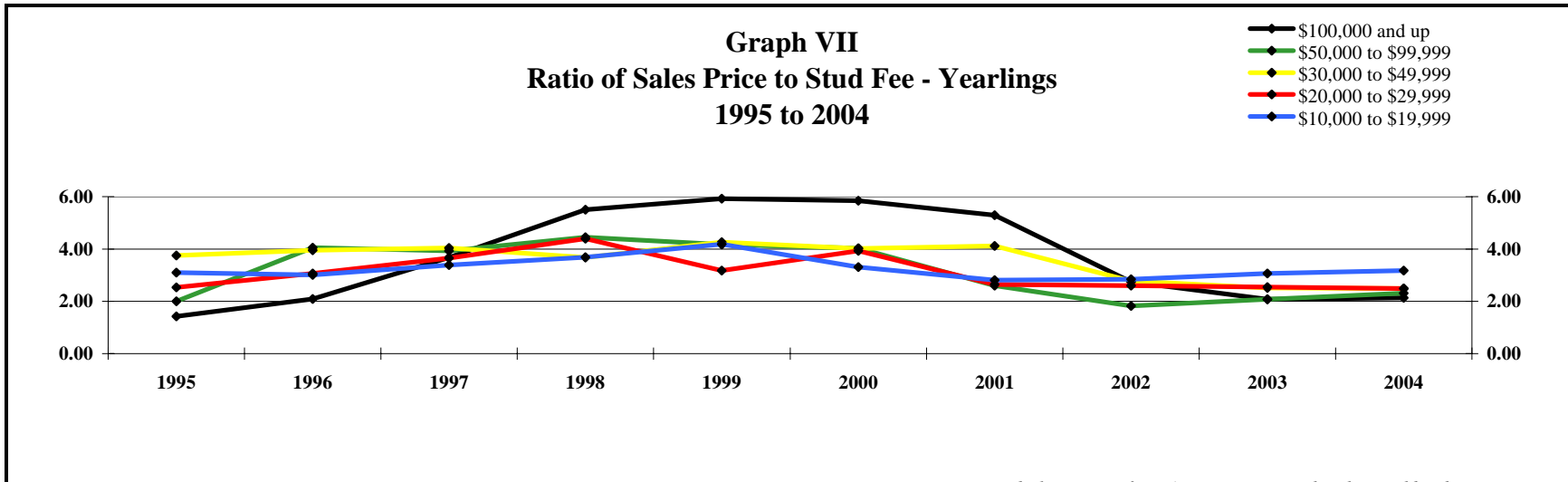
Commentary on Graphs V and VI

- We have analyzed data which shows the relationship of yearling (Graph V) and weanling (Graph VI) sales results to stud fee costs over 2000-2004, segmented by stud fee ranges (for the breeding year). These graphs show the portion of average sales price consumed by related stud fees, and add two other significant components of cost, a 5% sales commission and the cost of boarding and otherwise caring for the foal from an approximate weaning date until sold and the dam for a year. For this latter cost, primarily board and veterinary, we used \$20,000 and \$13,000 for yearlings and weanlings, respectively. We have not included sales tax on stud fees, because not all states tax stud fees and because stallion owners who use their seasons are not subject. The balance of average sales prices not consumed by the specific costs outlined above is available principally to cover the cost of using the mare for a year to produce the foal and, hopefully, to provide a profit to the breeder.
- The table below shows the percentage change from the prior year in the amount of selling price available to cover the cost of using the mare and to produce a profit, broken down by the stud fee ranges shown in the graphs.

Percentage Change from Prior Year in Selling Price Available for Mare and Profit

Stud Fee Range	Yearlings		Weanlings	
	<u>2003</u>	<u>2004</u>	<u>2003</u>	<u>2004</u>
\$100,000 and up	-31%	-9%	-77%	83%
\$50,000 to \$99,999	92%	80%	104%	112%
\$30,000 to \$49,999	-28%	-8%	-57%	124%
\$20,000 to \$29,999	-11%	92%	-30%	407%
\$10,000 to \$19,999	367%	43%	69%	1017%

- In Graph V and the above table, note the declining “profitability” in the case of yearlings resulting from breedings to the highest-priced stallions. Note, also, the substantial improvements in results from breeding to stallions in the other stud fee ranges, except the \$30,000 – \$49,999 range.
- In Graph VI and the above table, note the increasing “profitability” for 2004 weanling sellers resulting from breedings to the highest-priced stallions.
- Note that this analysis does not take into account costs associated with barren mares and lost foals.



Commentary on Graphs VII and VIII

- Considerable published data is available to breeders on stud fee multiples (sales price of yearling or weanling as a ratio of related stud fees) on a stallion-by-stallion basis. We have taken the data that groups stallions by stud fee ranges – see Graphs V and VI – and looked in Graphs VII and VIII at trends over time and relationships among different stud fee ranges. In doing this analysis, the stud fees are from the breeding year, not the sales year.
- The following table shows stud fee multiples for **yearlings** sold in 1995 through 2004, by stud fee range:

Stud Fee	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
\$100,000 and up	1.4	2.1	3.7	5.5	5.9	5.9	5.3	2.7	2.1	2.1
\$50,000 to \$99,999	2.0	4.1	3.9	4.5	4.2	4.0	2.6	1.8	2.1	2.3
\$30,000 to \$49,999	3.8	4.0	4.0	3.7	4.3	4.0	4.1	2.7	2.5	2.5
\$20,000 to \$29,9999	2.5	3.1	3.7	4.4	3.2	3.9	2.6	2.5	2.5	2.5
\$10,000 to \$19,999	3.1	3.0	3.4	3.7	4.2	3.3	2.8	2.8	3.1	3.2

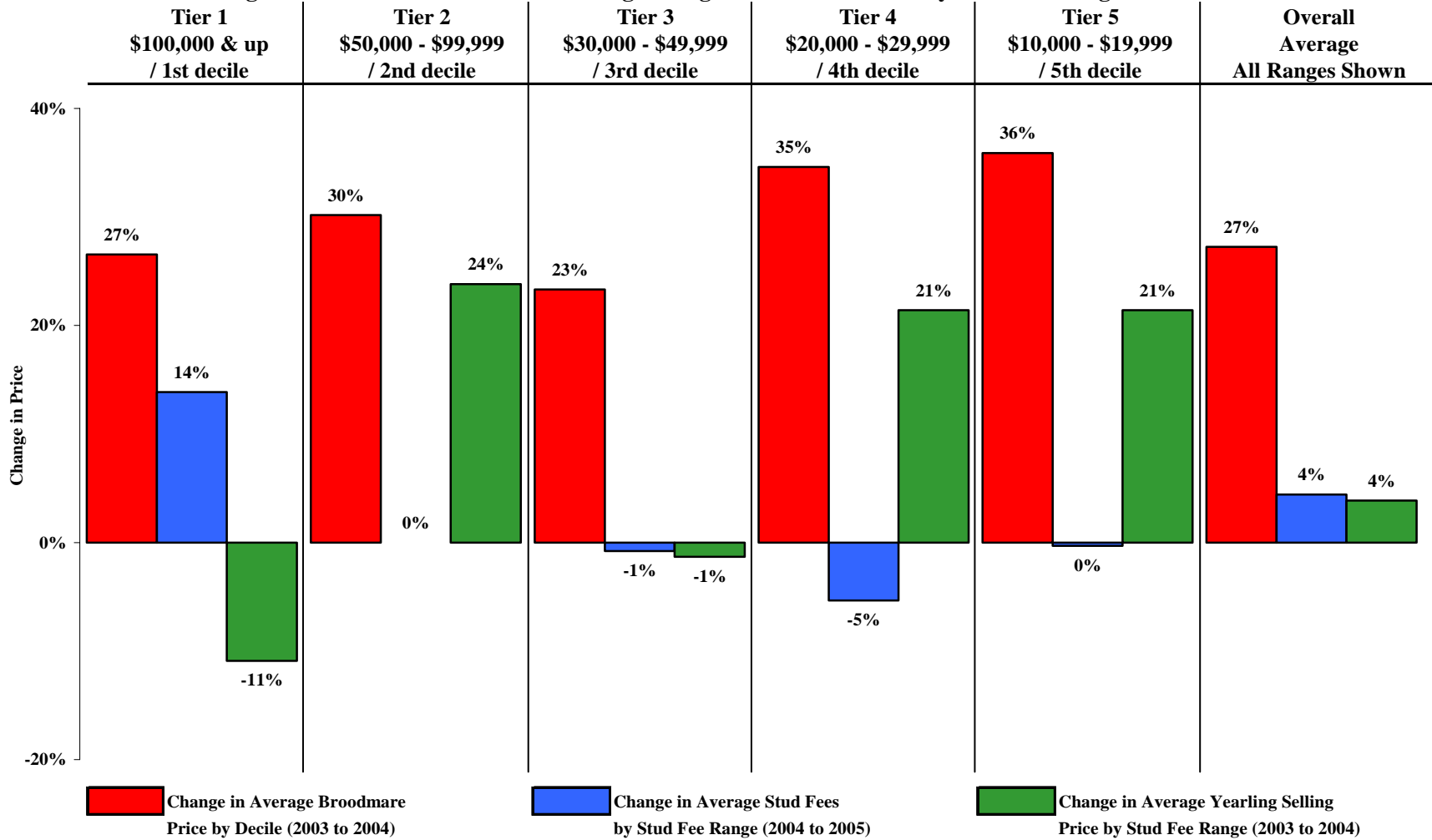
- Note that yearlings sired by the higher-priced stallions had multiples below the other stud fee ranges in the mid-1990s, had substantially greater multiples in 1998-2001, but similar multiples in 2002-2004. In 2003 and 2004, the multiples were somewhat higher at the lower stud fee ranges we examined.
- This table shows stud fee multiples for **weanlings** sold in 1995 through 2004, by stud fee range:

Stud Fee	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
\$100,000 and up	2.4	2.9	3.4	5.0	3.5	3.2	2.8	1.5	1.8	2.6
\$50,000 to \$99,999	2.2	2.8	3.1	2.9	3.0	1.9	1.5	1.6	2.2	2.8
\$30,000 to \$49,999	3.7	4.0	4.0	3.7	4.3	4.0	4.1	1.8	2.2	2.1
\$20,000 to \$29,9999	2.2	3.3	3.0	2.4	2.8	2.3	1.9	1.8	2.5	2.3
\$10,000 to \$19,999	2.3	2.7	2.8	2.8	3.0	2.3	2.3	2.2	2.7	2.7

- Note that stud fee multiples for weanlings for each stud fee range were relatively uniform for 2004, ranging from 2.1 to 2.8. In 2003 and 2004, stud fee multiples increased for the two highest stud fee ranges.

Graph IX


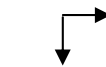

Changes in Production Costs and Yearling Selling Prices for Breeders by Stud Fee Range and Decile



Data from The Blood-Horse and Thoroughbred Times

Commentary on Graph IX

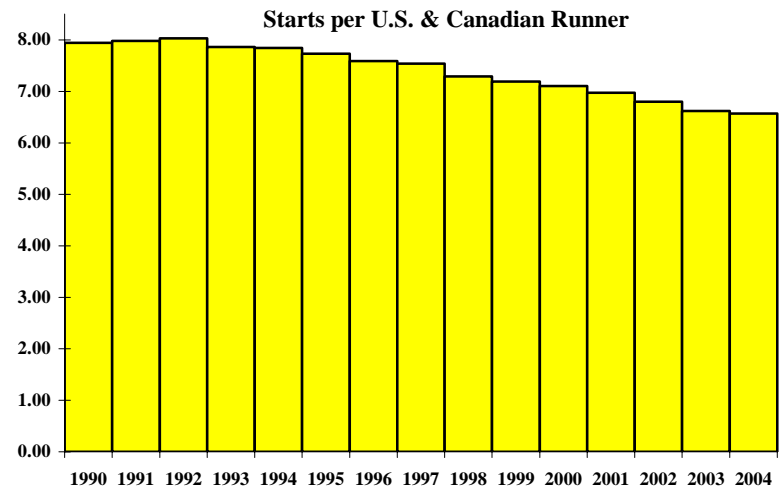
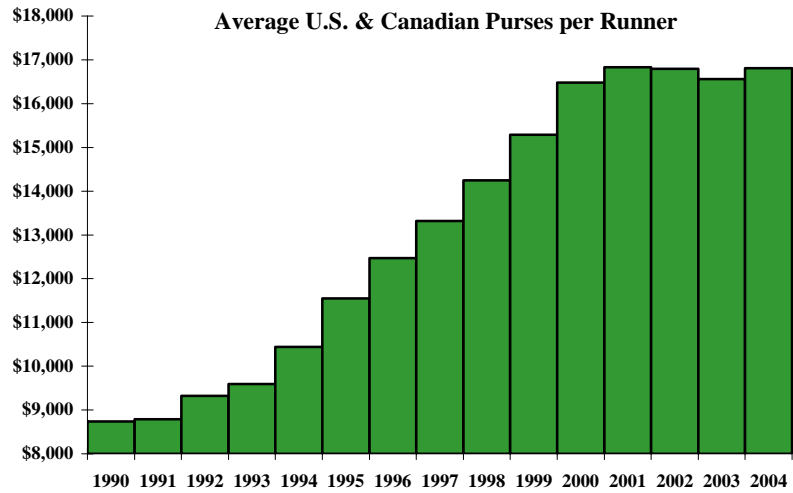
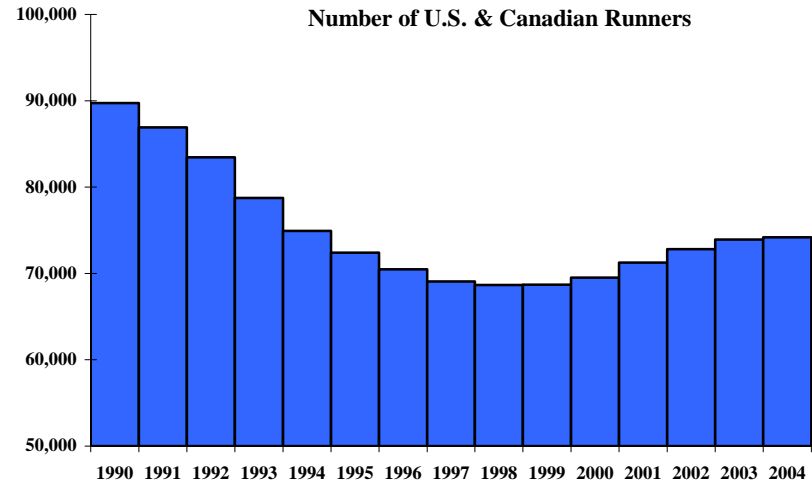
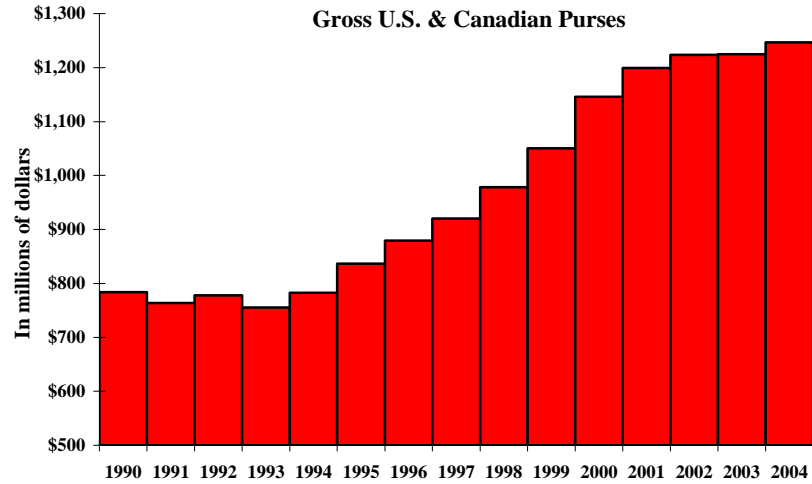
- In Graph IX, we try to provide insight into a critical question for breeders: Are your production costs increasing at a higher or lower rate than the prices you're receiving for your products? For costs of production, we focus on the two major elements: (1) broodmare costs – based on public auction prices – and (2) stud fees. For sales prices of breeders' products, we examine auction prices of yearlings.
- The analysis is based on current production costs and current sales prices and does not attempt to correlate sales prices with the costs of producing these foal crops. In other words, we are focusing on current costs – replacement costs – and current sales prices.
- Specifically, we are measuring changes in stud fees by the change in published stud fees by stallion from 2004 to 2005. For broodmares, we are measuring the change in this cost by reference to changes in average auction prices from 2003 to 2004. Similarly, the change in sales price of yearlings is measured by reference to average auction prices from 2003 to 2004.
- We segment our analysis into five tiers:

Tier	Stallion cost – stud fees of:	Mare cost – prices for reported sales at public auction:	Sales prices – yearlings sold at public auction and produced from stallions with these fees:
			
1	\$100,000 +	Top 10%	\$100,000 +
2	\$50,000-99,999	2 nd 10%	\$50,000-99,999
3	\$30,000-49,999	3 rd 10%	\$30,000-49,999
4	\$20,000-29,999	4 th 10%	\$20,000-29,999
5	\$10,000-\$19,999	5 th 10%	\$10,000-19,999

These tiers can be considered to represent approximately the top one-half of the thoroughbred breeders' market. We also show the overall changing cost and price levels for all the tiers we analyzed.

- The data shows mixed results. In the highest end of the market, broodmare prices and stud fees are increasing, even though top tier yearling prices are declining. In general, the cost of broodmares is increasing greatly (27%) and stud fees are increasing moderately (4%), resulting in substantially higher overall production costs. Selling prices of offspring as yearlings are mixed, down for yearlings bred to the highest priced stallions, but up overall (4%) – see last column.

Graph X
Racing Purses and Numbers of Horses Racing
1990 - 2004



Data from the Blood-Horse and Thoroughbred Times

Commentary on Graph X

- From 1990 to 2004, average purses per runner have increased from \$8,700 to \$16,800 – 93%. 2004 average purses per runner increased after decreasing slightly in 2003. Note how average purses have leveled since 2001, after a 10-year run of steady increases.
- From 1990 to 1994, the increase in purses per runner was due primarily to a decrease in the number of runners (by 17%) – gross purses changed only negligibly from 1990 to 1994 and were slightly lower in 1994 than in 1990. From 1994 to 2001, on the other hand, the increase in purses per runner was due primarily to an increase in gross purses available to owners (by 53%). Note that average purses per runner increased in 2004 even though the number of runners did as well, resulting from an improvement in gross purses.
- 2004 was the fifth consecutive year of increases in the number of runners and the eleventh consecutive year of increases in gross purses.
- Also note that the increase in average purses per runner from 1990 to 2004 - 93% - has kept pace with the increase in the average cost of purchasing yearlings over the same period – 80%, but is below increases in the cost of purchasing weanlings and two-year-olds – 102% and 187%, respectively.
- Starts per runner continued to decline in 2004, the twelfth consecutive year. In 1992, the highest of the 15 years considered, average starts per runner was just over 8; by 2004, the average had declined to 6.6.