CHAPTER 1

Kirk Kerkorian

DUE DILIGENCE IS DUE EVERY TIME

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Like so many of the Armenians who came to the United States in the first great wave of immigration starting in the late 1800s, Ahron and Lily Kerkorian gravitated to California's San Joaquin Valley—specifically, to its raisin industry.

It was a natural. The viticulture industry began, scholars tell us, somewhere around 6000 BCE in what is today Armenia, Azerbaijan, and Georgia, and in that perfect climate for growing and drying grapes, the descendants of those first raisin producers perfected their expertise. Thousands of years later, Armenians fleeing poverty and the oppressions of the Ottoman Empire found California familiar territory for the agriculture to which they were accustomed and fertile ground for their yearnings for freedom and opportunity.

The Kerkorians were able to satisfy both yearnings. When World War I brought raisin production in the Middle East to a virtual standstill, Ahron Kerkorian, savvy if illiterate, rode the raisin boom in the United States to an astonishing height, becoming, on paper at least, a rich man. This wealth did not last, however; Ahron would be caught in the postwar recession of 1921, when the nation suffered the steepest one-year price deflation since the Revolutionary War—a 36.8 percent decline in wholesale prices that swept away jobs and fortunes from coast to coast. Matching the general economic trend, raisins suffered a sharp decline in aggregate demand combined with a sharp increase in aggregate supply. The severe economic contraction that resulted wiped out Ahron's

on-paper holdings and plunged the expanding family—a fourth child, Kerkor, called Kirk, had been born in 1917—into hardscrabble urban poverty in what was then the fringes of Los Angeles.

Eighty-eight years later, ironically enough, Ahron's youngest son would evidence a similar failure to foresee an economic downturn. Though the failure would prove costly—to the tune of some $700 million—it would not have the kind of damaging financial consequences that had affected and perhaps had helped mold the four-year-old Kirk. In fact, it would make barely a dent in the Kerkorian fortune, then estimated in the neighborhood of $18 billion, give or take a billion.

Such wealth made Kerkorian at the time the world's forty-first richest individual. And while nearly $10 billion in casino and hotel losses dropped Kerkorian down the list in succeeding years, he remained among the world's top 100 billionaires. Still, even when he stood at number 41, investing $1 billion and ending up with $300 million represents a sizable mistake.

Complacency creates blind spots. And blind spots, in addition to keeping you from seeing what's there to see, prevent you from seeing that you have blind spots. The complacency that cost Kirk Kerkorian $700 million in 2008 may have been inexcusable, but it was almost understandable. Kerkorian had had such a string of hits that it was virtually unthinkable he would flop. That, of course, was the blind spot.

At the age of 91, with no apparent evidence of diminished mental acuity, Kerkorian had every reason to adhere to—and no reason whatsoever to dismiss or disdain—the formula he had employed time and time and time again in achieving a success both unarguable and pretty much unmatched as a trader of companies. Buy an undervalued company, push up the value, be patient while the macroeconomy strengthens, then sell. That was the formula. It had worked brilliantly for decades across a range of industries and in the face of shifting economic conditions. Yet in 2008 it stopped working. Something had changed; there was some sort of shift, some rearrangement in the pattern of facts that had persisted over all his other investments. And Kerkorian didn't see it. He didn't see it because he failed to look for it. Maybe he forgot to look, or maybe he simply figured that with a half century of wildly successful investing under his belt, he really didn't need to look—that he knew what he needed to know without looking. Whatever the cause,

the failure to look was a misstep on the part of a man who rarely put a wrong foot forward—at least where money was concerned. And it necessitated a Hail Mary move to stanch the bleeding of other holdings that were propping up the losing investment. All in all, it was an ugly loss for a man who doesn't like to lose and who, in a very long, very colorful, very eccentric life, has rarely lost—again, at least where money is concerned.

Kerkorian's personal life, which often has been fodder for the gossip game, is beyond the purview of this book and extraneous to its purpose—except perhaps to note that the private investment firm through which he does his trading, Tracinda Corporation, is named for his two daughters, Tracy and Linda, by his second wife, Jean Maree Hardy. For more on Kerkorian's colorful life, see the classic biography, *Kerkorian: An American Success Story*, by Dial Torgerson.[1]

Hemingway Meets Horatio Alger

In background and experience, Kerkorian is light-years away from the brilliantly educated, immaculately groomed billionaire investors whose ranks he overarches: rugged wilderness to their manicured golf courses. He himself claims that he first began bringing home some bacon for his impoverished family at the age of nine, and he concedes that doing so instilled in him "a drive that's a little different, maybe a little stronger, than somebody who inherited."[2] Maybe. It is certainly true that Kerkorian's early resume is that of a character out of Hemingway—boxer, bouncer, hero pilot—fitted into a classic Horatio Alger narrative arc.

A tough street kid who learned to box under the tutelage of his older brother, Kerkorian was expelled from one school for fighting and dropped out of another, the school for delinquent boys to which he was subsequently sent, to concentrate on fighting. Eighth grade marked his highest academic achievement, but in boxing, he went on to win the Pacific amateur welterweight crown. Paperboy, golf caddie, steam cleaner, car refurbisher, trail builder for the Civilian Conservation Corps: Kerkorian acquired numerous skills in an aimless succession of jobs until one day, at the age of 24, he accompanied his boss on a flying lesson, got a bird's-eye view of California from the ocean to the Sierra Nevada, and was hooked.

Kerkorian learned to fly at the Happy Bottom Riding Club in the Mojave Desert, hard by what is today Edwards Air Force Base.

It's the place where "the right stuff' was defined and honed, and Kerkorian's teacher was the pioneer aviatrix, Florence "Pancho" Barnes, owner of the club and, in the movie of *The Right Stuff,* the sharp-tongued woman behind the bar. There was a war on; eschewing the infantry, Kerkorian put his piloting expertise to work on behalf of Britain's Royal Air Force, ferrying Canadian-built De Havilland Mosquitoes, famous for their multiple capabilities as combat aircraft, from Ontario to Scotland.

There were two routes across the North Atlantic. One was slower and safer; the other was faster but had a 25 percent failure rate—failure here being tantamount to ditching in the North Atlantic, with serious if not fatal consequences. But the faster, more direct route paid more, and that was the one Kerkorian rode—straight out at jet speed across the west-to-east airflow known as the Iceland Wave. Over two and a half years, Kerkorian delivered 33 "Mossies," broke a crossing record, was given the rank of lieutenant, and managed to save the bulk of his wages—enough to buy a $5,000 Cessna and set up as a general aviation pilot.

He was 28 years old and a bachelor. Like a lot of Angeleños in the immediate postwar era, he had discovered Las Vegas, a city where, at that time, you could still see the night sky. Kerkorian gambled heavily and for high stakes—a habit he would eventually overcome, although he still reputedly enjoys showing up at the tables of one of his casinos now and again. In 1947, however, he needed and was able to borrow money from the Seagram family to pay $60,000 for a small air-charter outfit, the Los Angeles Air Service, which Kerkorian optimistically—some would say bombastically—renamed Trans International Air (TIA). He then scoured the world for war surplus bombers, and although many of them were in poor shape, it didn't matter to Kerkorian because they all had fuel—a commodity in desperately short supply at the time. Kerkorian sold the airplane fuel, paid off his loan, and still had the planes—the basis of TIA's fleet. He operated the airline until 1968, at which time he sold it to Transamerica Corporation, netting $85 million in the deal. It wasn't the last time Kerkorian actively involved himself in the running of a company. But after that, he mostly turned to the business of buying and selling.

Passions Leading to Profit

It is tempting to think we can find in Kerkorian's background the attributes of the business genius he became. He followed his

passions, was willing to risk, and had the discipline to scrutinize a situation objectively when it was needed. For example, he loved flying, and aircraft became the cornerstone of his fortune. He loved gambling—at one point excessively—and he turned it into ownership of a large part of one of the world's largest casinos. And perhaps above all, he possessed the eye to see value where others saw none and to read the economy in ways others did not. Of course, he also had the drive—the sheer brazenness—to act on what his eye perceived.

It's tempting indeed to see all this in Kerkorian's tough-kid background, but it's also fatuous at best and dipping into psychobabble at worst. The fact is that in his trading career, Kerkorian followed a tried-and-true, simple, straightforward formula: He bought undervalued companies—occasionally selling off assets to help fund the purchase, added strategic resources to augment and enhance the value of the companies, then sold his stake in the companies at a profit. He exhibited patience in waiting for the value to rise, and he evidenced discipline and agility when it came to knowing when to get in on an investment and when to get out. It is also the case that his choices of undervalued companies were often singular, although eventually, of course, investors would follow where Kerkorian led. But the singularity is notable: Kerkorian would buy planes that could barely move and sell the fuel that made them move; he would buy land in the desert when land in the desert was something people fled from; he would buy a movie studio and turn it into a hotel company. He saw something in each of these circumstances that others did not see. Or he saw the circumstances in unique ways, looking past the obvious to perceive some undeveloped potential that simply eluded others.

That was certainly the case in 1962, when Kerkorian bought 80 acres of desert across the Strip from the Flamingo Hotel in Las Vegas. Since the 80 acres were landlocked by a narrow and useless band of desert owned by someone else, Kerkorian swapped acreage for the narrow band and rented out his parcel to Caesars Palace. He made $4 million in rent money from Caesars and raked in another $5 million when he sold it to the hotel's owners in 1968.

He purchased more land in Las Vegas, fast becoming a boomtown, and in 1969, he built the International, the largest hotel in the world. That year, he also made his first foray into Hollywood. Borrowing $42 million from European banks, Kerkorian paid out $650 million to gain a controlling interest in MGM, then began selling off several of its key assets—backlot acreage, the distribution system, and such memorabilia as Dorothy's ruby slippers from *The*

Wizard of Oz and the chariot Charlton Heston rode in *Ben-Hur*— so that he could turn the company into a casino-resort business.

Show business, hospitality, gambling—Kerkorian saw it all as entertainment. In building Las Vegas resorts in MGM's name, he was simply conflating two epicenters of the genre. Witness the launching of the MGM Grand Hotel in 1973: It offered a spectacle of star performances, a new concept of a Las Vegas resort as a "family" destination, and a celebration of sheer size, for the Grand was the largest hotel in the world for *its* time. Kerkorian sold the place in 1986 for close to $600 million, banking a profit of approximately 500 percent. In 1993, he built a second MGM Grand—again, the largest in the world for its time. Seven years later, in 2000, Kerkorian merged the Grand with Mirage Resorts to form MGM Mirage, a global development company with holdings in "gaming, entertainment, and hospitality" that have continued to earn him a fortune.

Meanwhile, back in Hollywood, Kerkorian was more than matching his Las Vegas trading activity in the movie business—a flurry of buying and selling that captures the essence of the man's financial wizardry. Although in 1979 he had proclaimed MGM mostly a hotel company, he nevertheless paid $380 million in 1981 for United Artists, then sold the MGM/UA conglomerate to Ted Turner in 1986 for $1.5 billion. The sale lasted 74 days—Turner had debt problems—and Kerkorian bought it back for a mere $780 million. In 1990, he again sold the company—this time to multiple investors for $1.3 billion—and in 1996, he again bought it all back. Finally, in 2005, he sold the movie company for the third time—to Sony for $2.9 billion—netting $1.8 billion on the deal.

Clearly, Kerkorian was a master negotiator, extracting prices from the buyers of his assets that were either too high to support the transaction or enticing them into transactions they were unable to afford. He would not have been able to do either had it not been for his vaunted patience—the ability to wait for the market to come to him instead of having to sell into a depressed environment. Kerkorian could exercise such patience because he had the advantage of not being overextended and not being on margin. He had the cushion afforded by a personal balance sheet that can absorb the negative effects from unpredictable and potentially debilitating economic hardship. And this advantage—this cushioning power—remained always available to Kerkorian, despite simultaneous involvement in multiple major investments.

Two other interesting patterns surface in this review of Kerkorian becoming a billionaire. One is his habit of playing with the house's money whenever possible—a lesson he may have learned at Las Vegas casino tables. Wherever he learned it, he applied the lesson to his airline business when he sold the fuel to pay for acquiring the planes, and he applied it again with MGM when he sold off its assets, booked the profits, and had the cream at the top to play with.

The other pattern that emerges is Kerkorian's willingness or perhaps inclination to navigate shifts in the macroeconomy. He was always patient enough to keep pushing up the value of assets he bought without ever being married to the investment. In that sense, he is the quintessential natural-born trader, who enters and exits holdings without any apparent regard to macroeconomic factors. Instead, he relies on his instincts to tell him the value of a holding—whether the value he sees is locked in a company or so mingled with other assets it would require surgery to isolate. It is said, for example, that Kerkorian originally purchased MGM in order to obtain the Leo the Lion trademark, which he intended to use for his hotels. Since that was the value he was buying, it's understandable that he would ultimately break apart the studios and sell the movie library and cinema artifacts. (Again, to Kerkorian, they weren't the point; they weren't the value he was after.)[3]

Of course, playing with house money is a good way to insulate yourself against swings in economic conditions, so the two patterns—patience and navigating macroeconomic shifts—are not unrelated. The seesaw buying and selling Kerkorian indulged in between Hollywood and Las Vegas illustrate the relationship—after starving MGM studios to build the hotels in Vegas, Kerkorian sold MGM in time to avoid the stock market crash and subsequent recession of 1974–75, and he sold holdings in both centers of his investment in 1986, just as the U.S. economy was pulling out of the doldrums and was again on the upswing.

What is clear is that where he could see compelling value in a company, Kerkorian was willing to invest in it even in bad economic times—confident that he could employ strategic initiatives to increase the company's value, then exit the holding as the economy recovered. And what had worked in Las Vegas and Hollywood sure looked like it would work in Detroit as well, as Kerkorian began his on-again, off-again love affair with the auto industry.

Kirk's Cars

Love indeed may have had something to do with it. It is said that Kirk Kerkorian has a sentimental fondness for cars. Not the customized Jaguars or racy Lamborghinis he can easily afford, but rather a Chevy Malibu, a Jeep Cherokee, a Ford Taurus—representatives respectively of what were once known as the Big Three automakers, all of which Kerkorian in his time has tried to buy.

It started in 1990 with Chrysler, the smallest of the Big Three. Kerkorian had struck up a friendship with the company's former chief executive officer (CEO), the legendary Lee Iacocca, who had been credited with turning around the automaker in the late 1970s—assisted, to be sure, by $1 billion of government bailout money. To Kerkorian, perhaps prodded by Iacocca, Chrysler's 1990 stock price—$9 a share—reflected recession fears and poor management rather than the possibilities of recovery. He eventually acquired just under 10 percent of the company—enough to force management to pay attention to him. By the beginning of 1994, the value of his holdings in Chrysler had quintupled to $60 a share. Kerkorian seemed pleased by this growth, and for a while all was quiet.

But "pleased" is not necessarily "satisfied." Sometime in 1995, Kerkorian seems to have concluded that there was more that Chrysler management could do to increase the stock price. With Iacocca again whispering in his ear, and with the stock hitting new highs, Kerkorian determined that the return he had already realized on his investment—a return greater than 500 percent—was insufficient. The company, Kerkorian decided, was still undervalued, and he bid $23 billion to acquire it in its entirety.

He was rebuffed. But Kerkorian is nothing if not a man of conviction where investing is concerned, and he continued to increase his ownership interest in the company. Meanwhile, his bid to buy the company—the threat of a takeover by a single investor—had scared the pants off Chrysler management, directly triggering Daimler-Benz's $36 billion acquisition of Chrysler to create Daimler-Chrysler. Kerkorian tendered all his stock to Daimler-Benz in the merger and, since his initial interest in the company had pushed up the stock price, walked away from the deal with $2.7 billion in profit. That is a 500-plus percent gain—a return in excess of the gross domestic product claimed by virtually all non–oil-producing African countries.

Had Daimler not come along to buy him out, it's likely that Kerkorian in due course would have sold his Chrysler holding in the open market—after all, Kerkorian dates stocks; he doesn't marry them. Probably, given the man's innate sense of timing, he would have ended the affair with Chrysler around the time the market started to become somewhat rocky. Had that happened, it's likely that he would have booked a positive return on the sale, although almost surely nothing like $2.7 billion.

Some years later, in 2007, Kerkorian made a second attempt to control Chrysler; he offered Daimler-Chrysler $4.5 billion for the American subsidiary. He was again rebuffed, and the company was instead bought by Cerberus Capital Management. Cerberus, a private equity firm with a then-stellar track record, acquired 80 percent of the company for $7.5 billion and the assumption of nearly $18 billion in labor costs. In essence, it was a complete write-down for Daimler, since the Cerberus proceeds went into a joint venture between the German auto company and the U.S. investment firm.

Had Kerkorian beaten out Cerberus and actually bought Daimler-Chrysler, it is likely that the financial disaster of 2008 would have wiped out his entire investment. In fact, with Chrysler forced to file for bankruptcy in 2009, that was the outcome for Cerberus. So the Daimler takeover in 1998 didn't just give Kerkorian a huge profit; it also enabled him to dodge a bullet that would soon be on its way. Sometimes it is better to be lucky than smart.

After two bites at the apple with Chrysler, Kerkorian launched his third attempt to control an auto company. He went after General Motors in 2005, acquiring close to a 10 percent stake to become the largest individual shareholder. This time, the guy whispering in his ear was Jerome York, a top executive at the Kerkorian investment company, Tracinda, a former chief financial officer (CFO) at Chrysler, and the man credited with saving IBM. Kerkorian installed Jerry York on the board, and York undertook a number of moves aimed at raising the company's value: operational streamlining, buyouts, other financial restraints, and merger talks with Renault and Nissan. But the GM board nixed the idea of a global alliance, and Kerkorian sold his stock for what was said to be a small profit only—estimated at a mere $112 million derived mostly from dividends.

Thus far, therefore, Kerkorian's record with the auto industry pretty much matched his record with Hollywood movie studios and Las Vegas resorts: one spectacular win, one mildly profitable draw.

His personal history as an investor and gambler's odds both would have told Kerkorian to go for the hat trick.

He did. And he ended up looking like a playground marbles novice in a professional football game.

The Ford Fumble

Maybe Kirk Kerkorian believed in the old saw about third time lucky. Luck, after all, is what attracts people to casinos. Kerkorian had always been on the right side of lucky: He is arguably the single most important figure in the development of the gaming industry. But there are plenty of lucky people in the world—and very few billionaires. So while Kirk Kerkorian may indeed be lucky, his luck is a by-product of incredible drive, vision, and investment brilliance. Nonetheless, even he would have to give a nod to good fortune for having mitigated what could have been much more significant losses with Chrysler and GM than the losses he eventually realized in his Ford experience. Kerkorian should have seen that. He should have been more introspective—and more diligent—in analyzing the Chrysler and GM trades before taking a third run at the motor companies. If he had been, he would have seen how close he came to losing billions from his investments in both those companies. And that might have made him hesitate before taking a third run at the auto industry.

Had Kerkorian done the diligence that was due, his own experience in the auto industry would have offered signals of an industry in trouble. Just consider: When Daimler bought Chrysler out from under Kerkorian in 1998, it was at the peak of the market; the economy as a whole, the auto industry in general, and Chrysler itself had all begun to roar back from a slowdown. It was a merger that appeared logical in terms of the synergies that could be realized in both the operational and marketing sense. Since each company had its niche, the merger would bring expansion without requiring reinvention of the wheel or starting from scratch. The two product lines complemented each other, at least on paper: Scrappy Chrysler had the moderately priced vehicles, from its legendary Jeep brand to subcompacts to trucks, that could round out the venerable German producer's singular focus on luxury—and vice versa. The two companies' marketing experience and capitalization contributions were equally complementary. Moreover, Daimler-Benz had long been the class of the field; these guys were aces at managing auto companies.

Yet not long after the aces took over, the fundamentals began to go south—big time. If a well-run company whose expert managers, steeped in industry knowledge, were unable to stave off precipitous decline in the value of their $36 billion acquisition, what chance did industry outsider Kerkorian stand—even with the assistance of a former auto company CFO? The auto industry is the largest manufacturing industry in the U.S. economy, linked to more other manufacturing and generating more retail sales and more employment than any other single industry. Yet the people running it cannot control the economy as a whole, the costs of basic materials like steel and gas, the price of labor benefits enshrined in collective bargaining agreements, or other fixed expenses. If they can't, it stands to reason that even a financial genius like Kirk Kerkorian can't—even on his luckiest or most brilliant day. And had Kerkorian looked closely at this experience, he would have seen that. Had he seen it, he might have acted differently in the matter of his Ford investment.

In fact, he had precedent staring him in the face. Steve Feinberg, the principal partner of Cerberus, shared a few traits with Kerkorian. Both were self-made billionaires and legendary investors. Both were also publicity shy and, importantly, both were staunch believers in the auto industry. Cerberus's acquisition had already begun to sour before Kerkorian bought his first share of Ford. As two members of the exclusive billionaires' club, and as members of an even more exclusive club—billionaires who own not just cars but car manufacturers—it would have been natural, and it would have behooved them both, to compare notes. If they did not, that was a mistake on Kerkorian's part. As this book confirms time and again, you can learn a lot from mistakes, and it is certainly better to learn from the mistakes of others than from your own.

But if deeper due diligence on Chrysler might have made Kerkorian hesitate, an incisive postmortem on his General Motors experience should have stopped him in his tracks.

Jerry York played a central role in the GM experience. A superb manager and an old auto industry hand, York was invited to join the GM board of directors as Kerkorian's representative—his hands-on auto expertise the perfect complement to Kerkorian's investment savvy. From the vantage of their collective insight and expertise, both men could look down the road—even in 2006—and see a threat of bankruptcy for General Motors. York was on record at the time as having estimated that at the rate the company was

burning cash, insolvency could be as close as three years away—a forecast that was to prove eerily prescient. To avoid the threat, York, in his director role, outlined a series of recommendations to his fellow directors and senior management.

He suggested cutting white-collar salaries, which they did; selling such brands as the Hummer, which they did not (Hummer would eventually be sold in GM's 2009 bankruptcy reorganization); reducing union wages and benefits, which was not viable, since such costs were governed by a collective bargaining agreement; and—most significantly—forming that alliance with Renault and Nissan. The idea here was essentially to cede management control of GM to Carlos Ghosn, CEO of both the French and Japanese carmakers. Nicknamed "the Icebreaker" for his ability to cut through anything standing in his way, Ghosn was the most respected manager in the industry at the time and, as the author of both the Nissan revival and the turnaround at Renault, arguably the best.

Not surprisingly, entrenched GM CEO Rick Wagoner did not like this idea, and it was roundly defeated by the board. York immediately resigned from the board, listing his reasons for doing so in a letter to board chairman George Fisher that quickly become public. York cited "the boardroom environmental situation" as a detriment to the change he believed was needed, and he criticized directors for being too deferential to management (i.e., Wagoner), and not sufficiently focused on shareholder value. And thus ended the Kerkorian flirtation with General Motors.

It should have been a warning on three fronts:

1. Added to his Chrysler escapade, this brush with GM offered Kerkorian an insider view, at least by the proxy of Jerry York's astute vision, of the fast deteriorating economic and financial fundamentals of American auto companies.
2. The sclerotic intransigency of the GM board of directors should have been a clue to Kerkorian that the pace of change in this industry—at least any change effected by existing management—was going to be glacial at best. That was significant because at Ford, he would face a board of directors even more entrenched than GM's—members with longer average tenure and a family of heirs tracing their roots in the company back 100 years and with sufficient stock to control every decision and forestall any change.

3. As GM began leading the way that year to clear out inventory by slashing sticker prices—its alternative, so to say, to entering a global alliance—the pressure was on for the other Big Two to do the same. In any industry with a small number of players, the behavior of one tends to influence the behavior of the others, and irrational behavior by one tends to ruin the fundamentals for all of them. Thus the others quickly—and irrationally—replicated the drive to achieve sales at any price. It should have been a tip-off to Kerkorian that all was not well in the industry as a whole.

Yet despite these realities, and despite being privy to information available to only a handful of people, Kerkorian turned his attention to the Ford Motor Company in early 2008. That it was the healthiest of the Big Three at the time was inarguable. Equally inarguable was that being the healthiest of the Big Three automakers in 2008 was like having the best complexion in a leper colony.

Perhaps, when you're a financial magician like Kerkorian, the conviction that you're looking at an undervalued asset comes in a dream or arrives as a physiological sensation—a gut feeling, perhaps, or a shudder of desire. However it manifests itself, Kirk Kerkorian looked at Ford in 2008 and again believed he saw compelling value in the company itself that was not reflected in the stock price. Proclaiming himself bullish on Ford's CEO Alan Mulally and CFO Donat Leclair, Kerkorian in April disclosed that he had acquired 100 million shares of the company and made a tender offer for 20 million more, raising his stake in the company from 4.7 percent to 5.6 percent for a purchase price of $170 million. In June, Kerkorian bought another 20 million shares to bring his stake to 6.5 percent—nearly 141 million shares of Ford stock for a total investment of close to $1 billion.

This was self-deception. With his first Chrysler investment and with his GM investment, Kerkorian had repeatedly maintained that he had no intention of acquiring the companies outright, but the possibility always lurked in the background—and everyone knew it. The possibility so positioned Kerkorian that he could at least acquire a seat on the board as a prelude to effecting change in the way the companies were managed. At Ford, the founder's heirs controlled 40 percent of the voting stock—enough to block any attempts at changes suggested by an outsider, not to mention an

unwanted takeover of the company. It's fair to ask, therefore—and Kerkorian should have asked it—what he thought his $1 billion was buying for him.

But the purchase had been made, and if all had gone according to the tried-and-true formula, now was when the fact of Kerkorian's financial resources, the legacy of his experience in investing in the auto industry, and Mulally's management initiatives would start to accelerate the uptick in the company's value. Certainly it was clear that the economy was weak, but the economy had been weak back in 1990 when Kerkorian acquired Chrysler shares and in 1995 when he made his bid for the company. Therefore, it was rational for him to assume that if he were patient, this asset would also recover its value and he would pocket his winnings.

Instead, it all began to unravel. With sales plummeting 35 percent, Ford reported record losses and abandoned its stated goal of realizing a profit in 2009. As its stock price plunged, the value of Kerkorian's $1 billion investment plunged along with it—by two-thirds. Toward the end of October, Tracinda announced in a filing to the Securities and Exchange Commission that Kerkorian had begun to unwind his stake, selling 7.3 million shares at $2.43 a share, nearly 65.8 percent lower than their average $7.10 buy price.

It was widely suggested that Kerkorian pretty much had to sell. Several days before, he had put up another 50 million shares of MGM Mirage—about a third of his total stake in the company—as collateral for his $600 million line of credit at Bank of America. The value of those shares had dive-bombed, forcing Kerkorian to pledge their dividends as collateral as well, while his shares of Delta Petroleum Corporation, also pledged as collateral, were themselves experiencing a multiyear low. Announcing that it saw "unique value in the gaming and hospitality and oil and gas industries," Tracinda asserted it would "focus on those industries." Translation: Stunned by the unforeseen steepness of his loss, Kerkorian may well have needed the cash from his sale of Ford stock to support his MGM Mirage holdings.

What Went Wrong

Here's what Kirk Kerkorian forgot:

He neglected to use his discipline to rein in his passion. While both were essential to Kerkorian's success, these two character

The Ford Fumble: Timeline

After being rebuffed in its attempt to buy Ford's Jaguar and Land Rover operations in 2007, Jerry York, acting for Tracinda, begins meeting with Ford CEO Alan Mullaly and CFO Don Leclair in April 2008.

April 27, 2008: York tells Leclair that Tracinda has acquired 100 million shares of Ford, a 4.7 percent stake in the company.

April 28, 2008: Tracinda makes a tender offer for an additional 20 million shares of Ford at $8.50—for a total purchase price of $170 million—bringing its stake to 5.6 percent.

June 2008: Kerkorian's Tracinda buys another 20 million Ford shares so that by month's end, his stake in Ford totals 140.8 million shares—a holding valued at $995 million. With 6.43 percent of the company, Kerkorian is Ford's largest private shareholder.

October 2008: Ford CFO Leclair resigns October 10; a week later, two key board members step down. Kerkorian lets it be known that he is "concerned." At the same time, Ford's stock price plunges to less than $3.00, demolishing the value of Kerkorian's investment in the company.

October 21, 2008: Tracinda announces it has sold 7.3 million Ford shares for an average price of $2.43 per share. Kerkorian's remaining 133.5 million shares in Ford are valued at $289.7 million—a two-thirds loss in value.

December 29, 2008: Kerkorian liquidates the rest of his Ford stake for a loss estimated at some $700 million—possibly as much as $800 million.

Source: Securities and Exchange Commission filings by Ford Motor Company, Tracinda.

traits eventually breed different results as they become at odds with each other. In the world of investing, emotion is the antithesis of discipline. Nonetheless, Kerkorian's passion for the American auto industry was a determining factor in his investing life; he tried once, twice, thrice, four times to buy into the Big Three. By the end, his batting average had gone from 1.000 to .250, and the reason was the fraying of the discipline he normally possessed. He simply was no longer objective.

Kerkorian succeeded brilliantly with his initial foray into Chrysler. Of course, he had resources and an ability to effect change

that very few other investors possess, but that is actually immaterial to this analysis. What counts is the formula that achieved success: Kerkorian bought at the bottom when negativity about the company and the economy was high; he patiently rode out the hard times until the economy and the industry recovered, and he eventually collected a significant premium on his initial investment.

It was a brilliant trade by a legendary investor—a good example of why he is one of the world's most successful businessmen.

Yet in his General Motors experience, Kerkorian was arguably more fortunate than skilled, as he invested in a company whose fundamentals were quickly eroding. What had changed? The competitive landscape, primarily. As everyone knows, U.S. auto manufacturers began to lose major market share to imported cars, which were seen as more attractive and better made. Moreover, legacy union costs affecting the Big Three—but not foreign car manufacturers in the United States—made it tough to price vehicles competitively. And even though the "Kerkorian factor" itself gave a lift to the company's stock, creating the impression of unrealized value, it could be argued that the shares were significantly overvalued during the period of Kerkorian's GM holding—as was indeed borne out by the aftermath.

Furthermore, Kerkorian's primary resource, Jerry York, was a former senior auto executive who was clearly predisposed to invest in the sector. No one will ever know if the changes that Kerkorian and York proposed to the GM board would have saved the company from its ultimate fate of entering bankruptcy proceedings, but given that virtually the entire industry was under significant financial strain, it is unlikely that the company with the worst balance sheet in the industry would have fared much better with York's proposed reforms than it fared without them. In any event, since the reforms were never fully implemented, the point is moot.

Nonetheless, for Kerkorian, the GM experience was a profitable trade—as measured by the share purchase and selling prices plus the dividend distributions. Moreover, he avoided disaster by exiting the trade when he did, and for that he owes thanks to GM's board of directors for turning a deaf ear to his proposals for change.

Kerkorian's second go-round with Chrysler was triggered when Daimler realized it had made a mistake in buying the company and began soliciting offers for its purchase. Kerkorian was willing to pay $4.5 billion for the same company that he had attempted to buy for

almost $23 billion in 1995. What was Kerkorian thinking? The very fact that a savvy industry insider, a strategic owner as opposed to a financial one—Daimler—is willing to take a $36 billion hit should be a wake-up call, a hint that excess caution should be employed. And indeed, a year after the transaction closed, Chrysler was all but insolvent, relying on a government bailout to stay in business. Kerkorian's $4.5 billion would have been wiped out.

And so we come to the Ford fumble, and it's as if Kerkorian's genius grows increasingly attenuated as he moves down the list to the last of the onetime Big Three. Why was the steepness of his Ford loss "unforeseen"? Why did everything that had worked for Kerkorian in the past stop working now? What had he missed? What was Kerkorian's billion-dollar mistake? Simple: It was letting his passion override his sense of discipline. His crush turned into a full-blown passion, abetted by significant profits from his first investment in Chrysler. And the passion eventually clouded his judgment.

He knew the economy was weakening; conditions in the gaming, entertainment, and hospitality business, in which Kerkorian had long been a major player, would have provided an early read on consumer trends. But he had seen many economic swoons before and had benefited by being aggressive during those times—his first buy in Chrysler in 1990 being a prime example of that. The difference in 2008 was that it was a different *kind* of economic downturn, just as the downturn that defeated Ahron Kerkorian in 1921 was different in kind from the usual economic downturns everyone could easily recognize. The one in 2008 was caused by an overextended consumer plagued by plunging home values, extremely tight credit—much more severe than in 1990—and the poor competitive positioning of the domestic auto companies. Kerkorian's primary consultant, Jerry York, had not properly calibrated these risks any more than Kerkorian himself had. (It is worth exploring whether York's judgment may have been affected by the terms of his deal with Kerkorian, which enabled him to share only in the upside and not in the risk.) Rather, two very, very bright guys looked at an investment model that was enslaved to prior cycles when economic and business conditions related to one another in different ways. The game had changed, the context had shifted, and they didn't see it. **They didn't see it because they didn't look. At least, they didn't look hard enough. Instead, they relied on what had always worked. That was the failure from which everything else flowed.**

Success can have a funny effect on perception—especially repeated success. Often, succeeding in a first attempt—a winning bet on a horse, a ring toss that falls perfectly over the neck of the bottle, a trade that reaps a superior return—imbues or perhaps infects an individual with a sense of security—almost surely a false sense, but powerful nonetheless. Replicating the success reinforces that false sense of security, lulling the person away from facts and dimming his or her ability to see that times have changed. In men's sports, they call it the winner's effect, when each succeeding victory causes a surge in testosterone that constitutes a performance advantage—until the testosterone level is so high that the athlete begins to misjudge time, distance, impact, risk—and loses.

Kirk Kerkorian orchestrated a brilliant investment in Chrysler in 1990, reaping billions of dollars. He went to the well again and came out okay. These successes were nothing if not a testament to the worth of his investment strategy. There seemed no reason to doubt that the same script—remaining patient through bad company performance to await an improved macroeconomy—would play out again in 2008. It didn't. As in 1921, the macroeconomy suffered a transformational shock, and Kerkorian missed it.

Times change, facts change, and no two investing scenarios are alike. Passion for a company should not be a significant data point of the due diligence process, as it was for Kerkorian, who had loved cars since boyhood. GM, Chrysler, and Ford were like the high school sweethearts who grew up and moved away, but Kerkorian's love for the whole idea of them persisted. Nothing goes on the same forever, nor should your investment approach. That's the one reality an investor should rely on.

Lessons Learned

- ***Passion is not an investment strategy.*** Don't let passion or initial success drive you to similar investments. There's no such thing as a single template that works forever.
- ***Always do your due diligence.*** While prior experience with a particular sector, stock, or investment theme is valuable in developing an investment opinion, due diligence must be performed afresh on all aspects of the trade to ascertain the existence and significance of any new factors.

- ***There are no return engagements in the investment world.*** No two investment fact patterns are the same. The global economy spins on a multitude of moving parts: macroeconomic trends, the competitive landscape, consumer spending. Therefore, hard data must be continuously and diligently updated, and assumptions must be challenged just as continuously and just as diligently. It must be assumed that even the same stock in the same industry always presents a different fact pattern that is likely to demand a different course of action.
- ***Question the source of investment advice.*** Challenge the basis of the advice, know who's on the other side. Whether you're dealing with a qualified broker, being counseled by a knowledgeable industry insider, or getting a stock tip from your dentist, keep in mind that whatever their reward, they are not likely sharing in the risk. While their advice may be well intentioned, their rationale for the investment, their risk profile, their overall exposure, and so on may be different from yours. Add your own due diligence before acting on any recommendation.
- ***Memorialize your experiences.*** Compare the investment under consideration to your past experience. If the stock "looks like" or reminds you of a stock you once invested in, recall whether that past investment succeeded or failed. Why? What happened to the stock price after you exited the investment? Were you lucky to get out when you did? Had you been mistaken or correct in your initial analysis of the company's fundamentals? That is, did the stock perform in accordance with the prognostication you derived from your analysis of the fundamentals—or not? If not, how did performance deviate from prognostication—and by how much? Granted, the asking and answering of these questions is not an exact science, but get as precise as you can.
- ***Inconsistencies are flags of caution.*** Any discrepancies that emerge from your questioning are warning signs; pay attention to them. It is no coincidence that the term "due diligence" was coined in the federal Securities Act of 1933. Practice it.
- ***Take advantage of hindsight.*** It's 20-20. Don't end up with a 10-10 assessment of the stock. In other words, take care not to squander the one true advantage you have in making the assessment: experience.