Sotheby's Fourth Quarter 2015 Earnings Call Outline
26 February 2016

Safe harbor: GAAP refers to Generally Accepted Accounting Principles in the United States of America. In this earnings call, financial measures are presented in accordance with GAAP and also on an adjusted non-GAAP basis. An explanation of the non-GAAP financial measures used in this earnings call, as well as reconciliation to the comparable GAAP amounts is provided as an appendix to the earnings release, which can be found on the Investor Relations section of the Company's website. Also, during the course of this call, the Company may make projections or other forward-looking statements regarding future events or the future financial performance of the Company. We wish to caution you that such projections and statements are only predictions and involve risks and uncertainties, resulting in the possibility that the actual events or performance will differ materially from such predictions. We refer you to the documents the Company files periodically with the Securities and Exchange Commission, specifically the Company's most recently filed Form 10-Q and 10-K. These documents identify important factors that could cause the actual results to differ materially from those contained in the projections or forward-looking statements.

Please see our investor webpage for a slide presentation which outlines Sotheby's fourth quarter and full year financial results.

SPEAKER: Tad Smith, President and CEO

Good morning. Thank you for joining us, and for your interest in Sotheby's.

- As a reminder, we pre-announced our fourth quarter earnings at the end of last month, so today's call will give us a chance to share a number of important updates on the market, as well as our progress against the four priorities outlined when I first joined.
- I will begin by briefly touching on 2015 results – and Dennis will elaborate on these later in the call – after which I will provide an update of our progress against our company's strategy, and then close my portion with the picture in early 2016.
- Adjusted Net Income* for 2015 is $143 million, or $2.07* per diluted share which is virtually flat versus 2014, and slightly above the range we pre-announced last month.
- Turning now to an update on the four priorities for the business I outlined back in March. As a reminder, they are:
    - First, develop and implement a compelling growth strategy.
    - Second, embrace technology more effectively both internally and through client-facing products.
    - Third, allocate capital well.
    - Fourth, attract, develop, and retain the talent within the organization as well as implement the processes to sustain the first three priorities.

<u>With respect to the first priority</u> – develop and implement a compelling growth strategy.

- The first element of the strategy was to improve our position within the fine art market and we took an important step in that direction with the acquisition of *Art Agency, Partners* in January.
  - The three principals of the firm, Allan Schwartzman, Amy Cappellazzo, and Adam Chinn, together with outstanding talent among our existing staff and other recent hires, will form the foundation of a new Fine Art Division focused primarily on 20th and 21st Century Art.
  - Our new organizational design will enable us to better allocate resources, provide efficiencies for superior deal-making, improve communications across categories, and create additional cross-selling opportunities.
- The second strategic element was to improve our private sales business.
  - It was clear that we needed a more coordinated and expert approach to grow our private sales. Bringing together buyers and sellers of art in private transactions is one of *Art Agency, Partners'* successful lines of business and they will be central to our efforts.
- The third strategic element was to reinforce Sotheby's client-first mentality.
  - Building an in-house advisory service is a key component, and the acquisition we made in January provides us with the core infrastructure, expertise and team to grow that business.
  - A commitment to data and research complements the relationships and experience of our talented team. We have added resources in marketing analytics and commissioned customer research to improve the client experience, both offline and online.
  - I will elaborate on some of the additional online developments later in the call, but first, a word on examples of the operational improvements we are undertaking based in part on the feedback we have collected:
    - We have begun improving and standardizing all basic client communications, including billing and shipping.
    - We will be launching an on-site pack and ship alternative for clients, rather than relying solely on outside carriers.
    - We are developing custom post-sale services tailored to the value of the property, which will provide a better client experience.
    - We are working on a plan to improve traffic flow and client engagement for events, auctions and exhibitions, particularly in our Manhattan headquarters.
- The fourth strategic element was to improve our positon in the middle market. As a reminder, we define the middle market as items with prices between $25,000 and $1 million.

  - Continued online development is critical to significant growth in the middle market – especially attracting new buyers and having greater reach through tools such as social media. I will elaborate on aspects of our digital development later in the call, but here are a few examples where we have had success attracting and engaging new audiences:
  - A pilot program of five online-only sales, which were successful with an average sell-through rate of 95% across all sales, but more importantly, were a draw for new clients – 64% of buyers were new to Sotheby's.
  - Going forward, we are focused on developing cost-effective operations for selling in the middle market. Among the solutions currently under consideration are: additional online-only auctions; a possible retail storefront for Sotheby's online; organizational focus on the middle market, potentially across selling categories with staff who are aligned to grow it; and continued innovations in our digital marketing.
- The fifth strategic element was a systematic review of our position within various markets and we have filled a number of gaps in our regional scope.
  - After substantially deepening our operations on the West Coast, we have promoted the leader of that group to oversee all of our regional offices in the Americas.
  - We reinforced our longstanding commitment to the West Coast, opening new offices in Los Angeles in Century City, and San Francisco in the Financial District. Both locations feature exhibition space, and will serve as a nexus for our clients, our international specialists, and local audiences.
  - We opened an office in Mumbai, building upon nearly three decades of working with the leading collectors and staging regular events in India.
  - We have begun plans to extend our operation in the Middle East – complementing the company's existing presence in Doha.
  - Looking ahead, we expect to share new organizational designs for Europe and the Americas with our staff next week.
- The sixth strategic element was to use the Sotheby's brand to enhance its growth profile in categories such as jewelry, automobiles, collectibles, financial services, wine, and, in subsequent years, potentially more lines of business.
  - With respect to cars, for example, in 2015 RM Sotheby's set the standard for the market with auction sales totaling $525 million, and an annual sell-through rate of 90%. RM Sotheby's also sold the top car of the year – the 1956 Ferrari 290 MM, which commanded $28.1 million in our December sale in New York.
  - Sotheby's Financial Services remains an area of focus for the company, and an opportunity for us to serve both client and shareholder interests. Dennis will elaborate later in the call, but for 2015, the average loan portfolio balance was $733 million, a 26% increase from the prior year.

- **Now turning to the second priority** - embracing technology more effectively both internally and through client-facing products. Technology and digital development at Sotheby's have never been more aligned, and we have made great strides over the last year:
  - We saw a six-fold increase in visibility online in 2015, driven in part by the largest, fastest-growing, and most engaged social network in the auction business.
  - In December, Sotheby's became the first major auction house to launch an app on the new Apple TV, which Apple named one of the "Best New Apps" within a day of launch. The app provides additional reach for our videos as well as access to a new audience, in over 80 countries, for all live and HD-streamed sales, already driving additional video views.
  - In 2015, traffic to our website increased 29%, contributing to a 48% increase in online registration, a 53% increase in online bidders and a 39% increase in online buyers – resulting in online sales totaling more than $100 million, an 18% increase on 2014 and a 44% increase in the number of lots sold online.
  - This is a trend we are continuing to see so far this year – year-to-date, the total number of lots sold online increased 75%, compared to the prior year, in part driven by a 133% increase in online bidders.
  - As I mentioned earlier, part of our strategy is to expand and experiment with sale formats – last fall we launched a series of five online-only sales to appeal to a wider audience and experiment with new categories and price points. We had great success – while the sales totals were relatively modest, each sale expanded our reach to new collector bases – 49% of registrants and 72% of bidders were new to Sotheby's.
  - Creating a seamless experience for our clients – new and established – is a priority for us online and offline and we have made headway on a number of process and technology improvements.
    - We conducted focus groups to test the usability of our website, and are using those findings to improve the registration process, which has been a hurdle, with significant bailout in the final steps of the process.
    - We simplified the registration process for new clients by removing a 24 hour hold, and we will continue to make additional improvements.
    - We introduced credit card payment for lots below $50,000.
  - Looking ahead: We will continue to experiment with online sales and we have several planned for 2016. We will also continue to experiment with sale format: live-online, time-based and possibly "buy now".
  - While some portion of lots failing to sell at auction are subsequently sold privately or reconsigned to later sales, more than 50% of unsold lots are returned to consignors.

We believe there are alternate sale formats for the unsold lots, as well as the lots we inevitably turn away based on a variety of factors, and will be developing these over the course of the year. These will deliver great value to consignors and our business.

- Next week, we will submit an iPhone app to Apple. It's just the first phase, but it's rich with content, including video, and we will continue to push out new releases on a regular basis. We also have an updated iPad app we expect to release by the end of the second quarter.
- We are making improvements to our e-catalogues so we can publish information about upcoming lots and sales much sooner, a win for both consignors and potential bidders.

- **Our third priority is to allocate capital well.** I will turn things over to Dennis shortly to provide an update, but first, let me take this opportunity to remind everyone that the clear priority of the board in allocating capital is as follows:
    - Manage the business and balance sheet prudently for long term shareholder return;
    - Be conservative with guarantees;
    - Be careful with capital expenditures;
    - Invest to grow the business long-term;
    - Divert excess cash to repurchase shares at current prices.

- **Turning to our fourth priority – people**. We must attract, develop, and retain the talent within the organization as well as create the processes to sustain the first three priorities. We remain focused on creating a high-quality work environment to further enhance the passion and creativity that is integral to our success.
- In the past year, we have made changes to our senior management team and in key areas of the business. There have been significant hires, promotions and a number of people have departed. We wish them well.
- I am very proud of our organization – we are well-positioned with a strong, experienced and unified team of winners poised to execute our strategic plan.
- And with particular respect to specialist areas, there is no question that we are absolutely the best in Contemporary, Modern and Impressionist, as well as in our more traditional strengths, including Old Masters.
- The Board has also approved changes to our incentive programs, which will drive accountability and teamwork. Our 2016 bonus program will evaluate our performance against annual company, team and individual goals that support our business strategy. The performance metrics will vary by role – but will focus on profitability and client service. Our

long-term plan will align to the creation of shareholder value, measuring a long-term return on invested capital.

- Finally, we have done a review of our talent at all levels, and I was energized by the quality and quantity of high potential talent deep into our organization.

- Now, let me shift for a moment to what we are experiencing so far in the first quarter of 2016.
- We recently held our sales of Impressionist, Modern and Contemporary Art in London, which had a number of bright spots and provided us with some tangible data points after intense anticipation by the media and collectors in the lead up to the auctions.
- While our London sales of $307 million were down 40% compared to last year's record totals, our sell-through rates were comparable to last February, and we witnessed an appetite on behalf of collectors to pursue great works of art with enthusiasm, sometimes at buoyant prices, and oftentimes with confidence when priced well.
- Sotheby's sold seven of the top ten lots for the two-week period, and among the highlights was Lucian Freud's *Pregnant Girl*, which sold for $23.2 million, above the pre-sale high estimate of $14.5 million.
- Last month in New York, our sales of Old Master Paintings totaled $94.8 million; short of pre-sale expectations, but our highest total for the annual series in five years.
- The undisputed star of the week was Orazio Gentileschi's Baroque masterpiece, *Danaë*, which sold for $30.5 million to the J. Paul Getty Museum in Los Angeles.
- There is a lot of focus on the markets in Asia, and speculation as to what impact the economic volatility in the region will have on a variety of markets, including ours. So far in 2016, our share of lots sold to Asian clients has fallen somewhat, but because Asian clients have bought some valuable works of art, the share of buyer hammer from our Asian clients has grown slightly.
- Quarter to date, our total aggregate sales are $438 million, 33% below where they were during the same period last year and are at levels that fall somewhere between 2012 and 2013.
- In terms of our outlook – and Dennis will give you more color in a moment – our company has a very bright future. At the same time, we operate in a cyclical business. Some of the cycles are shallow and short, others might be a bit deeper and a bit more prolonged. The most recent sales of the company confirm that we have in recent months been experiencing a period of lower sales in the art market than in the 2014 and 2015 period.
- At the same time, we are incredibly excited about our future. After a year of transition, we have a super team with a clear mandate to build a more valuable business for shareholders and a more responsive one for new and existing clients. We will likely have one or more difficult quarters as we ride through the current cycle, but we are being careful on guarantees

and capital commitments, scouring the balance sheet and the company's operation for sources of cash, watching our liquidity carefully, continuing to invest in the people and capabilities that will drive our future success, and taking the opportunity with our excess cash to repurchase shares to the benefit of our shareholders. We are confident in our future and managing the business through uncertainty with a clear eye on creating value now for shareholders and clients.

- With that, I think it makes sense to turn things over to Dennis to speak first about capital allocation. He will then take us through the 2015 numbers as well as the outlook for the first quarter of 2016.

SPEAKER: Dennis Weibling, Interim CFO

- Thank you, Tad.
- I am pleased with the progress we have made so far with the repurchase of our shares. We have been buying shares on the open market since shortly after we pre-announced fourth quarter earnings last month. Since then, we have repurchased 4 million shares or 6% of shares outstanding.
- Our capital allocation framework considers the full array of our capital needs –supporting business requirements and opportunities, pursuing growth initiatives and, importantly, ensuring appropriate liquidity for any environment. It includes a comprehensive examination of Sotheby's capital structure, liquidity, cost structure and opportunities for growth. We stress tested the business throughout the cycle and under different market conditions over the last ten years and I am very comfortable that we can breakeven on a cash basis on significantly lower net sales levels than we have reported today.
- As I said on our earnings pre-announcement call, this is quite a robust process and I have a good deal of confidence in our work. This detailed examination of our capital structure demonstrates the resilience of the business through an economic cycle.
- And, as Tad just stated, no one can predict art market cycles with certainty. Sotheby's, through many cycles over the years, worked to structure reduced cost implementation in down cycles and invest to cover increased activity in more robust times. We continue to push hard on costs, and as we have more certainty on what this means, we will provide you with specifics.
- A key element of our capital allocation is, of course, real estate. That said, we own our York Avenue headquarters in New York, so we have the flexibility to continue considering our options. And not to overlook London, I reiterate that we are in the right location on New Bond Street, where there is currently no mortgage on that property.
- Closing our comments on capital allocation, some additional thoughts on our debt structure. There are currently three debt facilities with outstanding balances – 1) the mortgage on our NYC headquarters, which was refinanced for significant net proceeds at an attractive rate and with the goal of ensuring flexibility. If we leased instead of owned our headquarters, the

lease payments would be significantly higher than our debt service cost. 2) We had $542 million in borrowings related to the financial services business at 12/31 which funds a majority of the $682 million in loans. The SFS debt is backed by substantial collateral that has a target 50% loan-to-value ratio and a maximum 60% loan-to-value under our credit agreement. That target LTV, our underwriting skills and our expertise in conservatively valuing loan collateral greatly insulates us from risks and losses. In fact, we have had only 20 basis points of loan losses on over $4.7 billion of cumulative financial services loans since 1991. Finally, 3) $300 million in senior notes for the agency business, not due until 2022, which ultimately can be supported by substantial assets on the balance sheet.

- With that, I will turn to our 2015 financials and I'll use the slide presentation we published this morning for my comments. Please turn to slide 2 of the deck.
- Full year 2015 Adjusted Net Income* is $143 million and Adjusted Diluted Earnings Per Share* is $2.07, compared to $142 million and $2.03, respectively, a year ago. The adjusted figures exclude restructuring and special charges, as well as leadership transition costs, charges related to Sotheby's voluntary separation incentive programs and income tax charges associated with the repatriation of pre-2014 foreign earnings.
- On an unadjusted GAAP basis, 2015 net income is $44 million or $0.63 per diluted share, as compared to net income of $118 million or $1.68 per diluted share in 2014. The difference is largely due to income tax charges related to the repatriation of foreign earnings.
- For the fourth quarter of 2015, Adjusted Net Income* is $81 million or $1.19 per diluted share*, a 3% and 6% increase from the prior year period, respectively. On an unadjusted GAAP basis, fourth quarter 2015 net loss is ($11 million) or ($0.17) per share due to income tax charges related to the repatriation of foreign earnings taken in the period.
- Before I turn to our main operating segments, I wanted to make a brief comment on the impact of foreign exchange movements on a number of categories I will reference.
- Overall, foreign currency exchange rate changes had a net unfavorable impact of approximately $7 million on Sotheby's operating income in 2015 in comparison to 2014, with revenues unfavorably impacted by around $33 million and expenses favorably impacted by $26 million.

Agency Segment

- Starting with the Agency segment on slide 3, excluding foreign currency impact, 2015 Agency segment gross profit decreased by $14.7 million, or 2%. Changes in foreign currency exchange rates contributed $28 million to an overall $43 million, or 6% decrease to $682 million as compared to 2014.
- Excluding foreign currency impact, Net Auction Sales increased $39 million or 1% in 2015. When you include foreign currency exchange rates, which contributed $174 million to an overall decrease, Net Auction Sales decreased $135 million, which is a 3% decrease.

- The Taubman Collection brought Net Auction Sales of $383 million in 2015 with no related auction commission revenues. For all other sales excluding Taubman, Auction Commission Margin would be 15.5% in 2015, which is an 80 basis point increase from prior year. Taking the Taubman Collection into consideration, Auction Commission Margin decreased from 14.7% in 2014 to 14.3% in 2015.
    - And, for the fourth quarter of 2015, for all other sales excluding the Taubman Collection, auction commission margin would have been 15.9% which is a significant improvement from the fourth quarter 2014 margin of 13.7% partly due to the low Margin Mellon sales in November 2014.
- Excluding a $2.5 million foreign currency impact, private sale commission revenues increased $3.6 million (6%) when compared to 2014, due to an increased number of high-value transactions completed during the year. Foreign currency impact brings the increase down to $1 million, or 2%.
- In 2015, changes in foreign currency exchange rates reduced auction direct costs by $2.7 million. Excluding foreign currency impact, auction direct costs increased $8.2 million (10%), primarily due to approximately $6 million of costs incurred to promote and conduct sales of the Taubman Collection.

Finance Segment

- Moving to slide 4, we see continued strength in Sotheby's Financial Services business.
- For 2015, the average loan portfolio balance was $733 million, a 26% increase from the prior year. As of the end of December, the period-ending loan portfolio balance was $682 million and credit facility borrowings were $542 million, resulting in a leverage ratio of approximately 79%.
- Finance segment revenues increased $18 million, or 38%, in 2015, reflecting the growth of the portfolio, which can be attributed to the increased ability to fund loans through revolving credit facility borrowings, the relatively low nominal interest rate environment, and the improved global reach of Sotheby's art-financing business, all of which allowed Sotheby's to fund a number of significant new term loans during the first half of the year.
- Finance segment gross profit, which is net of borrowing costs, increased $11 million, or 28%, in 2015. The overall improvement in Finance segment gross profit is partially offset by the higher cost of revolving credit facility borrowings and financing of the loan portfolio with debt, which began in February 2014 and continued throughout 2015.

Marketing Expenses

- In 2015, marketing expenses increased $2.8 million, or 17%, as a result of costs incurred to enhance Sotheby's brand preeminence and accessibility.

Salaries and Related Costs

- Next on slide 5, salaries and related costs decreased $8 million overall, or 3%, in 2015 as compared to 2014, largely due to a $19 million reduction in incentive compensation expense.
- 2015 results are impacted by leadership transition severance costs of $13 million incurred in association with the departure of certain executive officers.
- Full time salaries decreased $4 million, or 3%, in 2015 principally due to changes in foreign currency exchange rates ($6.6 million). Excluding foreign currency impact, full time salaries increased $3 million, or 3%, in 2015.
- Share-based payment expense increased by $5 million, or 22%, in 2015 largely due to the accelerated recognition of $3 million of compensation expense related to the terms of severance agreements with Sotheby's former Chief Financial Officer and former Chief Operating Officer, as well as higher amortization of CEO share-based payment awards.
- Excluding foreign exchange impact, overall salaries and related costs increased $6 million, or 2%, in 2015. As I just mentioned, a large portion of the year to date increase is attributable to leadership transition severance costs.

General and Administrative Expenses

- Turning to slide 6, general and administrative expenses were largely flat in 2015 when compared to 2014.
- Excluding foreign exchange impact, general and administrative expenses increased $7 million, or 4%, in 2015 when compared to the prior year.
- The increase in the year to date period is partly due to a charge related to an unexpected authenticity claim related to property sold several years ago.

Net Interest Expense

- Net interest expense decreased $2.3 million, or 7%, in 2015 almost entirely due to the July 2015 refinancing of the mortgage on Sotheby's York Avenue headquarters in New York.

Income Tax Expense

- Sotheby's effective income tax rate was 77.5% in 2015, compared to 39.2% in 2014, primarily due to income tax expense of $65.7 million recorded in the fourth quarter of 2015 to recognize incremental income tax on pre-2014 accumulated foreign earnings that are no longer going to be indefinitely reinvested outside of the U.S.

Q1 Outlook

- Moving to this year's first quarter – a year ago, our first quarter results were our second highest in Company history, only eclipsed by a record-breaking 2007, and included a number of very strong events such as: record London February Impressionist and Contemporary sales of $533 million, robust New York March Asia Week and January Old Master sales, as well as the London Contemporary single owner Bear Witness sale last March, which totaled $50 million.
- Today, with our year-to-date aggregate auction sales 33% below where they were during the same period last year, we anticipate a significant net loss quarter for the first quarter of 2016.

[*] Non GAAP financial measure. See Appendix to Fourth Quarter 2015 slide presentation for details.