Sotheby's Third Quarter 2017 Earnings Call Outline
November 3, 2017

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 in the Company's Form 10-Q for the period ended September 30, 2017. 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-K and Form 10-Q. These documents identify important factors that could cause the actual results to differ materially from those contained in the projections or forward-looking statements.

SPEAKER: Tad Smith, President and Chief Executive Officer

- Thank you for joining us this morning.
- Today, we are reporting a third quarter loss per share of ($0.45) compared to ($0.99) in the prior period, a 55% improvement. After excluding certain charges in the prior period, Adjusted Diluted Loss Per Share* improved 42% from ($0.78) to ($0.45).
- For the nine month period, diluted earnings per share is $0.78 compared to $0.14 in the prior period. After excluding certain charges in both periods, Adjusted Diluted EPS* improved 84% from $0.43 to $0.79.
- Two factors favorably affected these results – a change in our Hong Kong sales schedule that added $82 million in Net Auction Sales to the quarter, and an unusual $7.4 million tax benefit, both of which Mike will touch on later in the call.
- The third quarter is a seasonally quiet one for us, so we are going to be relatively brief this morning. I will start with an update on the market overall as well as look ahead to our important fourth quarter sales, and Mike will then take us through the financials.

- Overall, the business and the market feel good and recent auctions and events reflect that view.
- At the tail end of September and the first week of October, we held our semiannual sales in Hong Kong.
    - The five-day series of 18 auctions in 10 categories totaled $404.1 million, a 42% increase year-over-year and a 20% lift over our spring sales held in April.

    - The sales achieved a combined sell-through rate of 86% and were led by an extremely rare 900-year-old vessel from the Northern Song Dynasty that sold for $37.7 million, a new auction for any Chinese ceramic.

- A few days after the conclusion of the Hong Kong auctions we staged a group of Contemporary Art sales in London to coincide with the annual Frieze Art Fair.
    - The results were solid: $114.1 million, which is a 10% increase year-over-year.
    - We held auctions of a similar size in London this past June and, all together, our global Contemporary art auctions are up more than 30% year to date.

- About two weeks ago, as collectors gathered in Paris for FIAC – the French international Contemporary art fair – we held three auctions devoted to the leading artists of the 20th century and they performed well, totaling $22.8 million and with a collective sell-through rate of 87%.
    - The results are encouraging given that we still have notable sales of modern and contemporary art and design coming up in Paris, including the *Collection of Jacques Grange*, the celebrated interior designer, which will be offered at the end of November and is estimated to bring in the region of $10 million.

- Before I turn to our upcoming sales, I'd like to pause for a moment to say a few words about the health of our auction business and take a look at a few positive indicators that bode well for Sotheby's and the market overall.
    - Excluding the $82 million in Net Sales from our September 29th and 30th Hong Kong sales (so we have an apples-to-apples comparison to last year) the statistics are very positive:
    - Compared to the nine month year-to-date period in 2016, we sold a similar number of lots, and held 8% more auctions for an 8% increase in net auction sales.
        - As a further indicator of health, when you look at that period on a constant currency basis, our Consolidated Sales – which as a reminder are a combination of our aggregate auction sales, private sales and sales from our inventory – are up 13%.
    - Client acquisition continues to trend upward: the number of first-time bidders was up 26% contributing to a 15% increase in all transacting clients for the nine month year-to-date period;
    - And particularly important for consignors and auction prices – we saw a 12% increase in the average number of bidders per lot.

- Turning now to our important November auctions – we are optimistic.
- The low estimate for our Impressionist Sales of $245 million is up 40% compared to much smaller sales held last fall.
    - The upcoming sales are led by two beautiful paintings by Claude Monet – one is a lush summer scene of the artist's beloved garden in Giverny, and the other is a modern and minimalist winter scene. Both paintings are estimated at $18/25 million each.
- The low estimate for our Contemporary sales is $323 million, up slightly – about 7% – compared to last November's results, which you may recall included the collection of Steven & Ann Ames that added nearly $115 million in net sales.
    - The top lot of the Evening sale, Francis Bacon's *Three Studies of George Dyer,* is estimated at $35/45 million, and is closely followed by Andy Warhol's *Mao*, which carries an estimate of $30/40 million.
- We are delighted to have been entrusted with works from several notable collections this season.
    - Among them are masterworks on paper from the Diamonstein-Spielvogel Collection. It is a particular honor to partner with Barbaralee Diamonstein-Spielvogel and Ambassador Carl Spielvogel, whose remarkable careers and civic and cultural engagement have had tremendous impact on this country and beyond.
    - They are generously contributing their proceeds to a charitable foundation in their name, which was established to support causes that they have actively championed throughout their lives, including: including medical research, educational innovation, and cultural projects with a focus on those relating to American history, diplomacy, and public policy.
    - Featuring works by artists ranging from Edgar Degas, Henri Matisse and Joan Miró to Jackson Pollock, Mark Rothko and Lucian Freud, their collection is estimated to bring $40/60 million.
- We are also honored to offer property from the Jerome & Ellen Stern Collection across a number of auctions beginning in November 2017 and continuing through spring 2018.
    - Assembled over 60 years, the unique collection comprises over 250 lots of Modern, Surrealist, Contemporary, Israeli and African Art, and 20th Century Design, and carries an overall estimate of more than $20 million.
    - Our Contemporary Art Evening sale will feature a number of works from the collection including a monumental sculpture by David Smith, estimated at $6/8 million, and a striking painting by Marlene Dumas, which is estimated at $3/4 million.
- We also have our major sales of Jewelry in Geneva and New York coming up in November and December, respectively.

    - The Geneva sale of Magnificent Jewels and Noble Jewels carries a low estimate of $102 million, which is slightly smaller than the total achieved at last year's comparable sale.
        - There are a number of standout pieces including: "*The Raj Pink*", the world's largest known Fancy Intense Pink Diamond, weighing 37.30 carats, which is estimated at $20/30 million.
        - That sale will also include *The Donnersmarck Diamonds*, a pair of Fancy Intense Yellow Diamonds with impeccable aristocratic provenance that is estimated to bring $9/14 million.
    - The New York sale of Magnificent Jewels in early December has a low estimate of $43.9 million, which is roughly double the size of the same sale last year.
        - Among the highlights is a Fancy Vivid Blue Diamond that is estimated to sell for $12/15 million.

- So, in short, we feel good and are looking forward to our upcoming auctions.
    - We open our exhibitions in New York in about an hour and encourage any of you in the area to stop by.

- I will now turn it over to Mike for a review of the results before we open the call up to questions.

SPEAKER: Mike Goss, Chief Financial Officer

- Thank you, Tad
- Tad and I share the view that we are seeing a relatively healthy market and are encouraged by the prospects for our upcoming sales in New York and Geneva.
- At the same time, we think it is prudent to wait and see how these huge sales actually perform over the next few weeks before we raise our expectations for the year.
- So why do we think this way in the face of a pretty strong third quarter report? Bear in mind two important pieces of context.
- The first piece of context is that the third quarter benefitted from two financially significant, but unique, events that can initially be misleading without further consideration.
    - The first event impacting this quarter is the $82 million of Net Sales from our fall auctions in Hong Kong that fell into this year's third quarter when last year none of the Hong Kong auctions occurred in the third quarter.

        - While yes, we were pleased with the overall performance of these sales, when viewing 2017 as a whole, it is important to recognize that the occurrence of these sales in the third quarter means that the fourth quarter will be negatively impacted to the extent that we all originally expected these sales to occur in Q4.
    - The second favorable financial event impacting this quarter is a $7.4 million income tax benefit we recorded by reversing a reserve that was established in 2013 to provide for a potential tax liability that is now beyond the statute of limitations for being challenged. The reversal of this reserve provided a $0.14 per share benefit to our loss per share in this quarter.
        - Because this is a discrete item unrelated to our ongoing effective tax rate, it will have no impact on our fourth quarter, but it will once again impact our full year tax provision by the same $0.14 per share benefit.
- The second piece of context impacting the analysis of this quarter has already been touched on by Tad, but it bears repeating. The third quarter is always our smallest quarter in terms of auction activity – 4.5% of sales volume last year – and therefore it is usually the least telling of our four quarters.
    - Furthermore, when we have timing issues such as the "Hong Kong pull forward" in an otherwise small quarter, our reported sales numbers for the quarter can be extremely confusing and misleading. To understand the state of our business, we think it's wise to look at our trailing six month data, or even the trailing nine month year-to-date data, which provides a more meaningful view. For those of you who have been on our previous calls, you've heard this advice before. But in this particular quarter, it's more important than ever.
- So let's look at the trailing six and nine month data and see what it tells us, starting with sales.
    - Our Consolidated Sales across all of our categories (which includes Aggregate Auction Sales, Private Sales, and Sales from Inventory, and is therefore the most comprehensive measure of sales activity), were up 8% in dollar terms over the comparable period a year ago for the trailing six months, and were up 9% in dollar terms for the trailing nine months.
        - We believe this range of 8-9% year over year growth in Consolidated Sales activity best represents the state of our collective businesses across the full spectrum of our selling categories and our markets at this point in the cycle.
    - In terms of Auction Commission Margin, we are roughly flat for the trailing six month period and we are up by 0.7% for the trailing nine month period. We are

pleased with this performance particularly given our greater mix of high end objects, which can drive down our Auction Commission Margin on a percentage basis.

  - To put into perspective how mix provides headwind on higher auction commission margins, consider this: in last year's nine month period, the items with a hammer price of greater than $3 million (the threshold at which our Buyer's Premium steps down to its lowest level) constituted 40% of our sales; in this year's first nine months, such items constituted 48% of our sales.
  - Importantly, we should also point out the marked improvement in "Other Agency Commissions and Fees" for the year-to-date period, the majority of which is the result of significantly better performance from our book of guarantees and more astute deal making.

- With respect to Adjusted Operating Expenses* (inclusive of Direct Agency Costs but excluding the cost of inventory sold or the cost of borrowings to finance our loan book at SFS), it is always very important to look at rolling six month periods in order to take into account the fact that we accrue for our annual cash incentive compensation in the second and fourth quarters.
  - With this in mind, our trailing six month expense level has been running at approximately $300 million, per six month period, which as you know from our previous calls this year, is running higher than the rate of a year ago, but it is entirely consistent with our planned investment spending against initiatives intended to drive future growth and the restoration of our incentive compensation expense to normal levels.
- Finally, let me point out one significant balance sheet item before turning the mic over to you for your questions, and that's our new inventory level of $63 million following the receipt of the cash from the sale of the Pink Diamond.
  - We've now brought our inventory down from $215 million at December 31, 2015 to this new, more economically rational level. This initiative has been a vital part of our overall goal to better allocate our capital from low yielding uses to business building activities as our first priority, and to stock buybacks after all such business building activities have been adequately funded.

- Tad and I are now available for questions.

* Non GAAP financial measure. See the Company's Form 10-Q for the period ended September 30, 2017 for an explanation of the non-GAAP financial measures used in this earnings call, as well as reconciliations to the comparable GAAP amounts.