Sotheby's Second Quarter 2016 Earnings Call Outline
8 August 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 in the Company's Form 10-Q for the period ended June 30, 2016. 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.

SPEAKER: Tad Smith, President and CEO

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

- This morning, we reported second quarter Adjusted Net Income* of $88.6 million and Adjusted Earnings Per Share* of $1.51, which compares to $73.1 million and $1.04, respectively, a year ago. This is a 21% increase in Adjusted Net Income*, but a 45% improvement in Adjusted Earnings Per Share* due to the share repurchases done in the past year – demonstrating the meaningful leverage from our ongoing capital allocation process.
- Mike will provide further details, as well as a more comprehensive explanation for this improvement in results, later on in the call.
- I'd like to spend my time with you focused on two issues: the state of the art market and our progress to date on our four main strategic priorities.
- First, the market:
    - There are a number of geo-political, macroeconomic, commodity pricing, and financial market uncertainties that leave the art market with a paradox. On the one hand, collectors are still buying top quality works of art in well-curated sales. On the other hand, consignors who have the luxury of discretion are showing a bit of reluctance to sell their work at this time.
    - This paradox has led to lower overall sales volume this year – down some 30% to date. However, when sales are carefully managed and thoughtfully executed, we have many examples of very good sell-through rates and record prices.
    - This was the case in our most recent sales in London at the end of June and also our Contemporary sale in New York in May.

  - Our June Impressionist Evening sale totaled $151.9 million, at the top end of our estimates, and major works by Pablo Picasso and Amedeo Modigliani sold for $63.6 million and $56.6 million respectively – the top two prices achieved at auction anywhere in London in over five years.
    - Furthermore, this well-curated sale was comprised of only 27 lots and achieved a sell-through rate of nearly 89%.
  - The following week our Contemporary Art Evening Sale totaled $69.4 million, also at the top end of our estimates, and with a strong sell-through rate of 87%.
    - 60% of the lots achieved prices over their high estimates and important auction records were set for Jenny Saville and Keith Haring, among others.
  - Nowhere was the demand for great treasures more apparent than in our Geneva salesroom in the middle of May. We set a new record for any jewelry sale ever held with a total of $175.1 million, eclipsing our own record set just a year ago.
    - The sale was 83% sold by lot and led by the *"Unique Pink"*, a supremely rare Fancy Vivid Pink diamond weighing 15.38 carats that sold for $31.6 million, which is just over $2 million per carat.
    - The sale also saw a new benchmark for a purchase by an online bidder in one of our auctions when a pair of *Important Pear-Shaped Fancy Blue and Fancy Orangy Pink Diamond Earrings* sold for $6 million.
  - Our results in Asia were similarly positive – our aggregate auction sales in Hong Kong in the first half of this year reached $461.5 million, up 22% over the prior year.
    - Our spring auction series saw sixteen auction records set and more than 80% of lots achieved prices at or above their mid-point estimate.
    - In addition, the total number of Asian clients buying Western art at Sotheby's grew 12% in the first half of this year, with top lots in both our Contemporary sales in May in New York and in June in London purchased by Asian collectors.

- Next, I would like to provide an update on our company's four main priorities. To remind you, these priorities are:
  - First, to implement a compelling growth strategy.
  - Second, to embrace technology more effectively both internally and through client-facing products.
  - Third, to build a talented team within the organization and the processes to sustain success.
  - Fourth, to allocate our capital more efficiently.

With respect to the first priority – to implement a compelling growth strategy:

- A key element of the strategy is to improve our position at the high end of the fine art market and we are making progress:
    - We continue to lead the market in the category of Impressionist and Modern Art and, as mentioned above, we achieved the two highest prices in the category during the recent London sales.
    - I am delighted with the strides that our Contemporary Department has made with excellent sell-through rates in our May and June sales of 95.4% and 87% respectively.
    - Both sales also performed well against their pre-sale estimates, and it's probably worth noting that these metrics are the most important to our consigning clients.
    - As for the coming season, Sotheby's outstanding team secured two of the most prestigious fine art collections on the market:
        - In New York, we will offer the collection of Steven and Ann Ames, a peerless collection of outstanding Contemporary Art, which is estimated to fetch in excess of $100 million. At the core of the collection are outstanding groups of works by two giants of 20th century painting: Gerhard Richter and Willem de Kooning.
        - And in London, we will present a three-part auction comprising approximately 400 items from the private collection of David Bowie valued at more than $13 million. At the core is Bowie's collection of Modern and Contemporary British Art – an outstanding group by many of the most important British artists of the 20th century, including Henry Moore, Frank Auerbach and Damien Hirst.
    - Over the past year, we have built a great team, made a number of key hires and realigned and focused existing talent.
    - That team today is very focused on profitable deal-making and more judicious use of guarantees, the benefits of which we're also starting to see in our financials.
- Another element in developing our growth strategy is to improve our private sales business and I mentioned in our last earnings call that will take a while.
    - Nevertheless, I am pleased with our progress here too.
    - We have added two seasoned colleagues to our team from Gagosian Gallery and The Warhol Museum.
    - We have spent a lot of time over the past six months considering our global S|2 gallery program– assessing its strengths and developing a concept for focusing the programming and creating a meaningful niche to further serve the needs of our existing and expanding clientele.
    - Leveraging technology to improve collaboration and efficiency is another critical component and we are making progress here too.

    - We have also reviewed and are making changes to our private sale incentive compensation program to motivate and reward staff more effectively.

<u>Now turning to the second priority</u> – to embrace technology more effectively and accelerate innovation both internally and through client-facing products:

- In the past year, we launched iPhone, iPad and Apple TV apps:
    - We have continued to refine those products and have successfully added functionality including search and auction results;
    - We recently added an Exhibition Audio Guide to our iPhone and iPad apps, making visits to Sotheby's, both online and offline, more dynamic;
    - Next steps for our mobile and app strategy through the end of the year include:
        - Expanding our footprint onto the Android operating system and increasing distribution of our video and auction streaming services through the likes of Amazon Fire and Samsung Smart TV.
        - We will also deepen integration into messaging platforms, specifically WeChat for our Asian audience, and begin to look to roll out transactional bidding capabilities on our apps.
- Later this month, we will launch the Sotheby's Museum Network, an aggregation of video content from the world's most renowned institutions, including the Metropolitan Museum of Art and the Tate.
    - There is a growing audience eager to learn about art and, increasingly, they are using digital means to explore. At the same time, the world has many public and private museums that may not have an efficient digital platform to promote their collections.
    - Many of those institutions are supported by some of the world's great collectors and we believe we can create an engaging digital hub for audiences interested in learning about art while at the same time creating a distribution channel for our most important clients in a way that differentiates us.
    - It will be available across Sotheby's digital platforms, most notably an updated version of Sotheby's Apple TV app, which was submitted to Apple last week.
    - In addition to syndication, the initiative will also include original content conceived and produced by Sotheby's, launching with *The Treasures of Chatsworth*, a 13-part series on one of Europe's greatest private houses and most significant art collections that is currently in production and will debut this autumn.

- We remain focused on online sales and continue to see them grow and play a more powerful role in our overall totals, as well as our engagement with clients:
    - Online sales in excess of $90 million were achieved in the first six months of 2016, a growth rate of 27% versus the same period of 2015.
    - We have seen a 54% growth in the number of lots sold online, accounting for 18% of total lots sold globally by Sotheby's compared to the same period last year.
    - The behavior is global and in nearly every category – London, Paris and New York have each held sales that sold over 25% of lots to online buyers.
    - As we have seen over the past year, awareness is an important part of engaging new and existing audiences:
        - We continue to work with our network of e-commerce partners to access the largest audience of bidders and buyers in the market.
        - We remain at the forefront of social media, with the industry's largest audience, embracing the latest trends including Facebook Live, which has driven tens of thousands of views to live streams about our auctions.
        - We also recently announced a sale curated by a major Korean pop star and collector with a short video that garnered more than 3 million views across social media channels in one week.
        - As a result of our efforts, registration for our auctions on Sothebys.com is up 57% compared to the same period last year.
    - Finally, as important as these innovations are to our existing business, these new technologies will be key to securing our desired position in the middle market.
        - Throughout the month of July, we presented a series of five online-only sales – at a time when historically the company, and our engagement with clients, was particularly quiet.
        - We offered a range of property – from Prints to Books and Contemporary Art – and the results were encouraging:
            - We had nearly 1,000 clients register to bid, an average sell through rate of 79% (including two sales that were 100% sold), and 33% of the buyers new to Sotheby's.
        - The top selling work of the series was *Untitled [Four Works]* by Bosco Sodi that sold for $125,000 in our Contemporary Online sale to a first time buyer at Sotheby's.
        - Looking ahead, we recently announced an online-only sale of jewelry by designer Tony Duquette that closes on August 30th, and we are currently filling out a full schedule of sales for the fall season.

- In summary, our company has made enormous progress against this second priority in the past year.

With respect to our next priority, that of people, my primary objective when I came to Sotheby's 17 months ago was to work with the many very talented people to fashion a team that performed at a level that was better than the sum of its parts.

- On the last earnings call, I said I was delighted with Sotheby's team and we have made tremendous progress and the only thing I will add in this earnings call is that our results in the most recent quarter have shown that.
- At the same time, we are not resting on our laurels and we continue to improve the excellent team we have.
  - For example, there have been a number of key hires in areas of priority including Contemporary art and Private Sales, as well as potential growth categories such as Contemporary African Art;
  - We have promoted a number of experienced Sotheby's colleagues in both the Americas and Europe to senior positions as Chairmen;
  - We have appointed new leadership in categories where we see opportunity: Wine, Jewelry and 20th Century Design, among others;
  - We have also successfully filled important positions in our digital and technology teams including heads of e-commerce and product development.
- We have an outstanding team and we are, even now, making it better.

Our final priority is to allocate capital well – I am extremely pleased with the progress we have been able to make on implementing comprehensive capital allocation policies that have delivered significant returns to shareholders. Mike will discuss this topic in more depth so at this point; I'd like to turn the floor to him.

SPEAKER: Mike Goss, Chief Financial Officer

- Thank you, Tad.
- Before I get to the progress we've made on capital allocation, I'd like to discuss our second quarter results.
- As Tad has already referenced and as our recently filed 10Q reflects, these financial results reflect the impact of six fundamental factors:
  - First, a lower art market which has led to smaller sales. In the Agency Segment, we experienced a 16% decline in Net Auction Sales. For a true apples-to-apples comparison, we should take into account last year's London Contemporary auctions, which were held in the third quarter. When you include the Contemporary sales, the decline in Net Auction Sales is closer to 24%.

- You might recall that in the first quarter, we saw a decline of 35%, so this period's decline was slightly more modest, though not what we want.
- The second fundamental factor impacting these results was an improvement in auction commission margin to 16.4% versus 15.5% last year. While much of this improvement was attributable to a shift in mix towards lower price bands, we believe part of this improvement can also be attributed to greater pricing discipline. We should also point out that this improvement represents the third consecutive such improvement versus the respective year ago periods when you exclude the effects of the Taubman auctions in the fourth quarter of 2015 and the first quarter of 2016.
- Third, we managed a 15% reduction in Adjusted Expenses* compared to last quarter, largely due to a $24 million decrease in incentive and share-based compensation expense.
- Fourth, our share repurchase program executed in the past year has led to a significantly lower number of shares outstanding. We now have 55.1 million shares outstanding versus 69.5 million shares a year ago. That's nearly a 21% reduction in the past year – and we still have another $43 million which is available for further stock repurchases under the current authorization.
- Fifth, our forecasted effective tax rate excluding discrete items is lower this year: 26% versus 35%. Two factors are driving this improvement. First, a year ago we assumed we would be repatriating all of our foreign earnings for redeployment in the US, and thus our 2015 foreign earnings were taxed at the highest US federal tax rate of 35%. This year, we believe we will indefinitely reinvest the majority of foreign earnings (except for our UK and a few other smaller jurisdictions' earnings) abroad, and thus large parts of our pre-tax income will be taxed at marginally lower foreign rates. Of course, this also means that our tax rate will consequently be dependent on the mix of our earnings among our various foreign jurisdictions, which brings me to the second reason for our lower rate for the quarter. In this year's current quarter, our lower forecasted effective tax rate was driven by the strength of our Hong Kong business where tax rates are lowest, and based on current projections for the year, we expect this lower tax rate to prevail for the balance of the year, but of course it will also be dependent on the exact mix of our earnings among the jurisdictions in subsequent quarters.
- The sixth and final major factor driving this year's improvement is that last year's second quarter results included a couple of unusual events which negatively impacted last year's second quarter. As you may recall, these included:
    - A significant loss incurred on a painting sold from our inventory, and
    - A cancelled sale provision and costs associated with a client authenticity claim – both of which were related to property sold in prior years. The charge for the authenticity claim accounts for the overwhelming majority of our favorable comparison in this quarter's "Other indirect expenses", which is recorded within the General and Administrative Expense line on our income statement.

- Looking ahead to the third quarter, many similar factors will work against us on a comparative basis versus last year's third quarter, and thus, we expect the third quarter to be quite weak, but the fourth quarter to be much better. These factors include:
    - As I previously discussed, the results of the London summer Contemporary sales were included in last year's third quarter, but will not be in this year's third quarter, and
    - Secondly, just as we had the significant loss from the sale of a painting in last year's second quarter, we had an equally significant gain from the sale of a second related painting from inventory in last year's third quarter.
- It is this "lumpiness" that reminds us why we consider it so important to focus on rolling six or full twelve month periods to get a better feel for the state of our business. Such an approach significantly lessens the impact of changes in the auction schedule or one-off transactions that might significantly impact the results of our seasonally small, and generally not very telling, first and third quarters. Such an approach also makes it easier to understand our cost structure given that we recognize most of our incentive compensation in the second and fourth quarters.
- Said another way, when trying to understand our business for this quarter, it may make more sense to look at it in combination with the first quarter. And likewise, when we report the next quarter, it will again make sense to look at it in combination with this second quarter.
- Turning to the balance sheet, the biggest story continues to be the progress we've made on capital allocation with the repurchase of our common stock under the $325 million authorization discussed with you in January and the significant EPS accretion we have experienced as a result. Since the increase in our authorization, we have purchased 11.0 million shares at an average price of approximately $25.68 per share for a total investment of $282 million, again indicating that we have about $43 million remaining under the current authorization.
- Tad and I are now happy to address your questions.

* Non GAAP financial measure. See the Company's Form 10-Q for the period ended June 30, 2016 for an explanation of the non-GAAP financial measures used in this earnings call, as well as reconciliation to the comparable GAAP amount.