Sotheby's Full Year 2018 Earnings Call Outline
February 28, 2019

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 (non-GAAP financial measures are denoted with an asterisk ("*") in this document). An explanation of the non-GAAP financial measures used in this earnings call, as well as reconciliations to the comparable GAAP amounts are provided in Appendix B to the full year 2018 earnings release as well as the Company's Form 10-K for the period ended December 31, 2018. 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 Form 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 Chief Executive Officer

- Thank you for joining us this morning.
- Today I will share the headlines of our financial results, review noteworthy successes from 2018, describe what to expect in 2019, and then review our investment thesis for our company. Mike Goss will then go deeper into the financials. Overall, you will see a company in great shape for the future.
- Before we begin, however, I am honored to announce that on March 11^{th}, Sotheby's will celebrate its 275^{th} birthday by ringing the bell of the New York Stock Exchange, and we will be celebrating this achievement throughout the year in ways to help our consignors, recognize our colleagues and benefit our shareholders.
- As a result of our entire team's efforts and the continued trust placed in Sotheby's by our clients, I am pleased to report that in 2018 we fulfilled our objective to substantially improve upon last year's good results.
  - Today we are reporting full year 2018 earnings per share of $2.09 compared to $2.20 in the prior period. However, after excluding certain items in both periods, Adjusted Diluted Earnings Per Share* improved from $2.25 in 2017 to $2.48 in 2018, a 10% increase.
  - For the fourth quarter 2018, we are reporting $1.72 in diluted earnings per share compared to $1.43 in the prior year period. After excluding certain items in both periods, Adjusted Diluted Earnings Per Share* improved from $1.47 in 2017 to $1.74 in 2018, an 18% increase.
  - On an operating basis, we are particularly pleased with our Adjusted Operating Income* for the full year 2018, which increased nearly 18% primarily due to the 16% growth in

Consolidated Sales, including growth in private sales of 37% to a total of $1.02 billion – a five year high, and nearly double the level achieved in 2016.

- As a result, in 2018 we achieved a second straight year of 20%+ after-tax returns on equity – which is a significant improvement from the average of just over 15% between 2014 and 2016.

- In addition to strong overall financial performance, our company once again achieved many milestones in 2018:
    - We led the market in Asia for the third year in a row with sales of approximately $1 billion, the highest total in our 45-year history in Asia;
    - In March, our London team achieved the highest price ever paid for any painting sold at auction in Europe with Pablo Picasso's beautiful portrait of Marie-Thérèse Walter, which sold for $69.2 million;
    - Our global wine auctions crossed $100 million for the first time, highlighted by a new record set for a single bottle of wine – $558,000 paid for a bottle of Romanée-Conti DRC 1945;
    - Our colleagues in France had their best year since the opening of the French market to international auction houses in 2001, led by the two-day sale of the contents of Pierre Bergé's last residences, which was 100% sold and totaled $31.3 million;
    - In May, we sold Amedeo Modigliani's *Reclining Nude* for $157.2 million, the highest auction price in Sotheby's history;
    - Our Contemporary team set countless auction records in 2018 including for works by Kerry James Marshall, Cecily Brown and John Chamberlain, as well as for any living female artist with a painting by Jenny Saville selling for $12.4 million last October;
    - Sales of Old Master Paintings & Drawings were up over 30% in 2018, and among the many highlights of the year was the sale of a rare oil sketch by Rembrandt measuring just over ten inches that sold for $12.1 million and is now part of the collection of the Louvre Abu Dhabi;
    - In Geneva, we offered 100 treasures from the Bourbon Parma Family led by Queen Marie Antoinette's pearl, which achieved an astonishing $36.2 million, tripling the previous auction record for a natural pearl;
    - Our watch team had a very good year with sales up nearly 57% and a new record set for a wristwatch sold at Sotheby's – "The Asprey", which sold for $3.9 million;
    - We held inaugural auctions in Mumbai and Dubai, and celebrated our 50th anniversary in Italy;
    - And our support of institutions continued in 2018 with sales on behalf of the Studio Museum of Harlem and the Georgia O'Keeffe Museum, among many

others, and the second annual Sotheby's Prize for curatorial excellence was awarded to the Academy Museum of Motion Pictures in California.

- We also achieved many digital milestones in 2018:
    - Online buyers spent $220.4 million in 2018, up 24% from the prior year – as a reminder, that total includes items from our live auctions purchased online, all online-only sales, as well as purchases made on our retail websites, Sotheby's Home and Sotheby's Wine;
    - We rolled out a new ecommerce platform that helped drive $72.1 million in online-only sales, quadruple the previous year's total;
    - 37% of all lots sold in 2018 were purchased online;
    - We saw a record number of new bidders in 2018 and 64% of those bid online;
    - Video views more than doubled in 2018 – to over 28 million – and Sotheby's video team won three prestigious awards including a Webby;
    - Sotheby's gained 1 million new social media followers in 2018 and leads the auction industry with a total audience of more than 2.5 million;
    - We had more than 1,200 items consigned through our new online estimate platform, resulting in $56 million in sales in 2018;

- My colleagues and I begin 2019 with a great sense of excitement about our company's future.
- Although we are the oldest company listed on the New York Stock Exchange, we are looking very fresh for our 275th birthday.
- Our mission has not changed: we help people discover, buy, and sell precious objects. Our strategy in pursuit of that mission employs trusted expertise, technology and service innovation to make it easy and effective for clients to work with us and thereby for us to generate attractive returns for investors.
- Many of our projects that we began two years ago have reached or will reach an inflection point in this calendar year:
    - Our program to upgrade our content management system was completed in 2018.
    - We have already been rolling out a new online auction engine together with mobile bidding and other features this year, as well as deployed new digital tools for our private sales business. Both will be substantially completed in 2019.
    - Our digital advertising, customer relationship management programs, digital video and editorial creation, and our social media reach have grown very rapidly in recent years, and this growth will continue.

- In 2019, Sotheby's Home, Thread Genius, and our online consignment platform will build a powerful foundation to drive highly profitable middle market growth for many years to come.
    - For example, in January and February alone, we expect to have consigned $16 million in property through the online consignment platform, which is a 162% increase compared to the $6 million combined during the previous two months.
- Also this year, we will complete the most significant transformation of our physical space in many years:
    - In May, we will unveil new galleries at our Manhattan headquarters, which will be the largest and most important state-of-the-art commercial gallery space in the world.
    - In October, we will unveil spectacular upgrades to our New Bond Street property in London.
    - In December, we will have completed the refresh of our beautiful gallery space opposite the *Elysée* Palace in Paris.

- With a strong team and the proper technology infrastructure in place, together with a new executive charged with driving global transformation, in 2019 we will continue to identify processes that would benefit from automation, simplification, greater alignment with customer needs, and, crucially, cost reduction or elimination. Our people will become more efficient, our client service will improve, and our investors will yield the benefits.
- And, of course, in 2019 we will be celebrating our innovation, our client service, our culture, and our 275 years of commitment to helping people around the world to discover, buy and sell the world's most precious objects.

- What does all of this mean for investors?
- Let's begin by saying that we are planning for another good year of 20%+ returns on equity and a very healthy balance sheet in 2019.
- We acknowledge that, although the base case expectation for our company in 2019 is favorable, the range of outcomes has a bit more uncertainty than when we entered 2018.
- On the other hand, there is a great deal of property in the marketplace that we have already won, and still much being competed for right now, especially for New York in May. And we expect the comparison of 2019 performance to 2018 to be much more favorable in the second quarter than in the first quarter, so keeping an eye on the six month performance is as important as ever.

- Moreover, we do believe that our efforts in recent years to retool the company to make it easier to do business with us will be beneficial when we next face market headwinds.
    - The middle market, for example, is not as sensitive to the cycle as the high end and our efforts to grow there are bearing fruit.
    - There will also be a new base of business that comes to us simply because our online consignment technology makes it easy to do so.
    - Finally, our technology platforms will enable us to be more cost efficient and flexible in our service offering.
- So we are quite pleased with our recent investment program and the one we are continuing in 2019.
- At the same time, our attractive returns on equity and good sales growth in recent years have not masked the fact that our investment program has somewhat dampened our recent EBITDA margins as well as pushed up capital spending compared to the company's historical norms.
- Beginning in 2020, we believe that the results of our investments will be much more visible – due either to contribution growth or our increased efficiencies or both – and our EBITDA margins will begin to climb and our capital spending return to a more typical level.
- On the occasion of our 275th birthday I hope I have given investors reason for great optimism. Yes, we are a seasonal business. Yes, we are a cyclical business. But we have significant secular growth tailwinds, a superb team that has a proven capacity to innovate and perform, a commitment to excellence in capital allocation, and, by the end of 2019, we will have substantially retooled the company's infrastructure over the past several years for more returns to come.
- Let me now hand the call over to Mike Goss for a deeper dive into our company's performance.

SPEAKER: Mike Goss, Chief Financial Officer

- Thank you, Tad
- Given our filing of this morning's 10-K and the inclusion of new data tables in our press release – both of which pretty well lay out the facts behind our 2018 earnings – I'd like to spend my time this morning providing context by which you should view our financial performance for the year just completed and the year that lies ahead.
- First, and perhaps most importantly, our Adjusted Operating Income* improved 18% versus last year, in large part reflecting the combination of two important factors: a 10% growth in Agency Commissions and Fees accompanied by only a 5% increase in Adjusted Expenses*.

- Our revenue growth is a reflection of both higher auction activity and higher private sales commissions. The lower expense growth reinforces the trend we've been focused on and communicating throughout 2018, namely that much of our investment spending has started to, and will continue to, moderate over time.
- Assuming the market cooperates, going forward, we expect to start seeing the benefit from this operating leverage, not only leading to continued margin improvement, but also allowing us to redirect our investment spending away from projects that were necessary to catch up on our infrastructure toward projects that can accelerate our growth or lower our operating costs even further.

- Secondly, I'd like to share a few thoughts with respect to our Auction Commission Margin. Although our Auction Commission Margin ("ACM") rebounded to 17.1% in the fourth quarter, for the full year, we reported an ACM of 16.1% versus 17.2% last year. As many of you may recall, our margin for the year was suppressed by two specific high value paintings in the second quarter. If you exclude the effect of these two paintings and look at what happened with the remainder of our business, our ACM would have been 16.7%. When comparing this level to the 17.2% level of 2017, those last 50 basis points are explained by the greater mix of higher value lots in 2018 and the higher percentage of competitive, price driven estate and charitable sales that drove market growth in 2018.
    - Looking ahead to 2019, we continue to see a market dominated by estate sales that can carry lower margins, but we also anticipate fewer of the very high value paintings that impacted 2018. On balance, the guidance we made at the end of Q2 that "16% is the new 17%" is still relevant, but we also see a pathway to slight improvement in 2019. I should note that we recently revised our Buyer's Premium schedule to help toward that end.
    - In addition, as our online-only sales and consignments from our online consignment platform become a larger part of our business, the impact on our margins will be quite favorable.
- Third, with respect to our balance sheet and capital allocation strategies, 2018 was clearly a year of further improvement and creation of shareholder value. During the course of the year, we returned approximately $295 million through share repurchases, retiring another 6.5 million shares, or 12% of the shares outstanding at the end of 2017. Today, we currently have 46.4 million shares outstanding.
    - We accomplished this return of excess capital to shareholders while simultaneously increasing our capital spending by $36 million (from $21 million in 2017 to $57 million for 2018) and managing our total of long term debt and revolving credit facility borrowings to very little change. In terms of our Adjusted Leverage Ratio*, which is calculated using our long-term debt divided by Adjusted EBITDA Excluding SFS*, you see we lowered our leverage ratio from 3.9x at the end of 2017 to 3.1x at the end of 2018.

- In fact, speaking of Sotheby's Financial Services, it's noteworthy that after seeing our loan balances decline through the first part of the year, we exited 2018 with a loan book nearly $100 million higher than this time last year. Our loan balance at December 31, 2018 stood at $694 million versus $591 million a year ago, which is a year-end high.
- Most importantly, with a much leaner balance sheet, our after-tax Return on Equity* for the year increased further to 24.4%, which we think is an overlooked, or perhaps underappreciated, characteristic of our business model.

- Finally, let me close with a few thoughts on how 2019 is starting out for us.
  - Historically, it is quite common for Sotheby's to report a loss in the first quarter, and this year will be no exception. It is still too early to get a firm picture of the first quarter but, for the most part, the results will be driven by strong performance in our New York Old Masters sales, offset by Brexit-driven smaller sales in London and any macro driven headwinds in Asia; we anticipate that our loss will be less than in 2017 or 2016, and instead closer to the ten year median first quarter loss for our company.
  - But interestingly, we're seeing a very strong pipeline of potential consignments for New York in May, in part because a sizable segment of the consignment market continues to come from a number of estates and charitable organizations.
- I look at these recent trends as yet another reason to track our results in rolling six month increments. By doing so, investors get a better feel for the state of our business free from the vagaries of the quarterly sales calendar. It also reminds us of the strength of being an international company competing in a global business insofar as our revenue is diversified by region and we benefit from consignors and buyers who shift their activities around the world and between quarters as they see fit.

* Non GAAP financial measure. See Appendix B to the full year 2018 earnings release as well as our most recently filed 10-K for the period ended December 31, 2018 for an explanation of the non-GAAP financial measures used in this earnings call, as well as reconciliations to the comparable GAAP amounts.