Sotheby's First Quarter 2017 Earnings Call Outline
May 10, 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 March 31, 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 my colleagues and me this morning, and we appreciate your interest in Sotheby's.
- On this call, we intend to cover the following four topics:
    1. What is the state of the market for art and luxury goods that Sotheby's sells?
    2. Now that the company's new management team has been here for two years – this is my ninth earnings call – what progress has there been against the four key priorities articulated in March 2015?
    3. From management's perspective, why are Sotheby's future prospects attractive for investors?
    4. Finally, we will close with my colleague Mike Goss' overview of the most recent quarter's financials as well as other relevant financial information for investors.
- Before we turn to these four topics, however, let me quickly summarize how we did in the first quarter.
    - As a reminder, the first quarter is a seasonally small one in which Sotheby's usually earns a loss.
    - Compared to last year, however, Sotheby's loss narrowed significantly.
    - Today we are pleased to report a net loss per share of (\$0.21) compared to a (\$0.41) loss per share in the prior period – a 49% improvement. After excluding certain charges in the prior year period, Adjusted Diluted Loss Per Share* improved 36% from (\$0.33) to (\$0.21).

    - While there were no big picture takeaways from this quarter's results, there were a few interesting nuggets that Mike will cover later on in the call.

- So what is the state of the market for the art and luxury goods that Sotheby's sells? In short, the market is starting to show signs of strengthening.
    - The message from our Hong Kong sales in April was that East and South East Asia's buyers were prepared to pay top prices for excellent quality art and jewelry.
    - Wine has been doing extremely well in all of our markets and some say that bodes well for other categories.
    - Moreover, we are pleased with our consignments for our Modern/Impressionist and Contemporary Evening and Day Sales to begin next week in New York.
    - If one looks at every auction we had in the first quarter of 2017 – a total of 36 sales – 69% of those sales have exceeded their low estimates, which is up from 57% last year and a particularly encouraging indicator that supply and demand are in balance.
    - Additionally, the average price of lots sold was 116% of the low estimate versus 94% a year ago.
    - At the same time, it is true that the market for consignments has been extremely competitive.
        - The Wall Street Journal did a piece at the end of February pointing to the arrival from "garden leave" of a number of new executives at our competitors, and it is fair to say our competitors have been very aggressive in the market.
        - The good news is that they and we have some outstanding works of art for the upcoming sales in New York, and great results at all of the auction houses will be very good for the market.
    - In terms of the macroeconomic and geopolitical picture facing the market, there is not much to add to my comments on the last earnings call other than that the world continues to benefit from geopolitical stability and also that the U.S. administration has announced tax priorities.
        - Broadly speaking, we believe that Sotheby's investors should be pleased with the possibility of a reduced U.S. corporate tax rate, a possible tax holiday on U.S. repatriation of cash (and Mike will give some figures on that later in the call), lower capital gains tax rates (especially if it would apply to art and collectibles), potential reform of the inheritance tax, and the waning

enthusiasm for the macroeconomic and microeconomic uncertainty of a border adjustability tax.

        - Elsewhere around the world, French leadership is now clear, Brexit is underway, oil and commodity prices are broadly stable, growth in developed countries is okay, China seems balanced between reform efforts and growth, while India seems poised to accelerate.
        - Finally, currencies have been largely stable since Brexit, and in America, consumer confidence is rising. The worldwide market for art is not perfect, but I would definitely characterize it as starting to show signs of strengthening.

- Now that the company's management team has been here for two years, what progress has there been against the four key priorities articulated in March 2015? Let me first remind our investors of the four key priorities:
    - First, to develop and implement a compelling growth strategy;
    - Second, to embrace technology more effectively both internally and through client-facing products and thereby to enhance the rate of innovation at Sotheby's;
    - Third, to build a talented team within the organization and as well as the processes to sustain success;
    - Fourth, to allocate our capital effectively and efficiently.

- <u>With respect to the first key priority, to develop and implement a compelling growth strategy</u>, your management team and Board have made clear progress over the past two years and there is plenty of encouraging work still to complete.
    - Today, we are exceptionally strong at the high end of the fine art market. And while from sale to sale we do not always lead in market share – indeed often we do not choose to do so – our sales are beautifully curated with magnificent lots at price points for many collecting tastes. And we anticipate that our sales will continue to deliver good margins as well as be hugely successful for our clients.
    - We are no longer merely an auction house as we have expanded to grow our art advisory business, which is thriving.
        - We have added clients and projects as well as staff to meet them;
        - We launched an artist estate advisory business and there again we have already added a number of clients;

    - Contrary to the opinions of some pundits, both of these advisory businesses are delivering where it matters – with our clients and shareholders.

- Our S|2 gallery business has a new clarified strategy refocused towards artists who have been celebrated in art history but are under-recognized by the market.
    - The new focus distinguishes S|2 as a destination for collectors looking ahead of the curve for opportunities.
    - It's a vision that will take into account the local markets and physical galleries that we operate in, with dedicated spaces in New York and London and plans to expand the identity to our existing gallery in Hong Kong.
    - We currently have exhibitions on view in New York and London that reflect this new vision:
        - In New York, we have shows dedicated to Alfonso Ossorio and Roy Newell. While these artists have many differences, both are distinguished for a creative output that stands alongside many of the giants of 20th century art.
        - In London, we are presenting two shows by the Austrian artists Renate Bertlmann and Maria Lassnig – both are key figures in the current discussions around the reevaluation of female artists of the post-war period.
- Our new strategy officer, Jennifer Deason, has been busy pursuing strategies to support the growth of our wine businesses, and the Board will be reviewing options later this week under the leadership of Luxury & Lifestyle Division head, Maarten ten Holder.
- We already have the world's leading position in wine auctions and the question is – how do we grow that business? Fortunately, we have options.
- The recent management focus on our jewelry and watch auction businesses produced the desired results in our Hong Kong and New York auctions and we are looking forward to healthy sales in Europe later this month.
    - We have lots of options to explore here on how to grow our jewelry business, and Maarten and Jennifer will be coming back to the Board after the wine reviews with further growth plans.
- With respect to automobiles, we have recently agreed to maintain our investment in and partnership with RM Auctions at the same level of ownership for the next two years while we work collaboratively on client and marketing opportunities.

    - This preserves our options with a terrific partner as well as was a good capital allocation move for both parties, and we look forward to building even more with that business in the coming years.

- <u>Turning to the second key priority, to embrace technology more effectively and accelerate innovation both internally and through client-facing products</u>, we have made excellent progress.
  - The truth is that, over the past two years, Sotheby's has become a powerful media company, with the ability to bring its scale and scope to bear to help our clients sell something, buy something, promote something, market something, or enjoy something.
  - We have numerous examples of our technological efforts beginning to pay dividends:
    - In our first quarter versus last year, online buyers soared 32%, with a 30% jump in online bidders close behind it.
    - Through April versus last year, the number of lots sold online rose to 21% of total versus 18% last year, and we had 17% growth in online value sold, 38% growth in the value of online underbids, and 25% growth in the number of online underbidders.
  - In fact, a recent report for the week of April 22nd on our online progress reads like a virtual tour de force of innovation:
    - Here is one example and I quote: "Dynamic retargeting banners were launched on Friday, which automatically customize based on known browsing behavior. This means scalable personalization is available for every sale with no additional resource needs." End quote.
    - Or here is another example from the same report and I quote: "Looking at e-catalog browsing on Sothebys.com so far this year, Contemporary has had the highest volume of traffic by over 2x the second most popular department. However, Chinese works of art has the deepest browsing (page views per visit) and jewelry has the most time spent." End quote.
    - Or here is my favorite: "87% of clients registered to today's Watches sale in London can be attributed back to our email and online advertising campaigns." End quote.
  - Clearly, Sotheby's is innovating and learning.

- As of April 29th, our year-to-date digital engagement versus the same period last year was up 35%; online paddle registrants up 34%; online bidders up 42%; online buyers are up 21%; and lots sold online are up 11%.
- Overall, online paddle registrants are now 53% of our total registrants versus 44% a year ago; online bidders are 38% of our total bidders versus 27% a year ago; online buyers are 26% of our total buyers versus 21% a year ago; and, as I mentioned just a moment ago, lots sold online are 21% of our total versus 18% a year ago.
- Total video views between 1Q15 and 1Q16 grew 101% and between 1Q16 and 1Q17 actually accelerated to 228% growth.
- A recent top client email was for Watches. It was sent to 28,289 subscribers, opened by 6,600 of them, generating website visits by more than 2,252 of them, and resulting in nearly thirty registrations. All of this for the negligible cost of an email.
    - It's also worth noting that 46% of the sold lots from that sale were purchased by online buyers.
- On social media, our company has 1.15 million followers spread broadly across WeChat, Weibo, Twitter, Facebook, YouTube, and of course Instagram. During the April 25th week alone we had a collective 107,000 likes. Both these "likes" for the week and the social media audience size were twice that of our major competitor.
    - And this does not count the fact many of our 1,600 staff have their own social media accounts and do their part promoting Sotheby's and its clients' interests.
- We mentioned in the last call a bit about our Museum Network, but its story is instructive as a narrative of increasing innovation here.
- The idea came to an executive last summer when he was meeting with clients:
    - He thought – there are thousands of museums around the world; can Sotheby's help our most valued clients by using its digital marketing scale and scope to promote their museums as well as to provide an educational resource to the world's art enthusiasts?
    - From that idea, we launched it several months later. And today we have 41 museums and 416 videos live. And this summer we are launching a new, better version of the web platform that will include 300 museums, going up to 500 museums by the autumn.

        - And most gratifying of all, the site usage is rising nicely, and we use the network in our consignment pitches.
    - Sotheby's is indeed learning and innovating in powerful ways with technology. And our clients, our shareholders, and our staff are the winners for it.
    - The key opportunity here is to figure out where we take these strategic new media capabilities – and that is a clear agenda item for our management and Board that did not even exist two years ago.

- The third key priority was to <u>build a talented team and then develop the processes to sustain our success in the future</u>.
    - I am very proud of our team: the ones that have been here for decades; the ones that have been here a few weeks; and everyone in between.
    - We continue to offer great development opportunities to experienced professionals from all over the world as well as to turbocharge the careers of graduates coming out of schools from many countries.
    - Where do we go from here? I think the hallmarks are greater depth in our most skilled areas, more rigorous succession planning for talent, and a more diverse workforce.
    - For Sotheby's, the hunt to attract, develop, and retain the world's best talent is never finished. And our processes and compensation programs continue to evolve to serve these needs.
    - Just this past month, I gave speeches at Wharton and Harvard to Chinese students studying there: two auditoriums filled with incredibly talented people interested in our industry and company.
    - And what was gratifying to me was how desirable a place Sotheby's is to work for the most talented and passionate graduates.
    - Our summer program accepts 27 from 650 resumes submitted. That 4% yield stands up to any elite US college, and Sotheby's clients and investors are the beneficiaries.

- Our fourth priority is to <u>allocate our capital efficiently and effectively</u>.
    - Mike will give the latest statistics on our company's share repurchases, but let me just cast a light on two examples of our capital allocation: guarantees and inventory.

        - For next week's sales, we currently have $217 million in gross guarantees outstanding to consignors, but only $40 million net guarantee exposure after offsetting the risk with irrevocable bids.
        - In other words, 20 of our 36 guaranteed lots for those auctions have irrevocable bids that ensure us returns consistent with our profitability requirements before the sales even begin. This is an extraordinary accomplishment for both clients and shareholders and even more so when you consider the expanding list of Sotheby's clients who are backing our guarantees.
    - In another area of capital efficiency, I direct you to our inventory account.
        - It appears at first glance that our inventory in the most recent quarter was only somewhat lighter than in December 2016.
        - However the text of the 10-Q reveals that our inventory account – based on transactions already completed – is expected to fall sharply in the second quarter.
        - We have been working aggressively over the past year both to convert inventory to cash and receivables, as well as to reduce the amount of new unplanned inventory we take on.
        - By "unplanned" I mean inventory that is booked as a result of failed guarantees in the auction room.
        - In March 2016, we held $205 million in inventory; in the most recent quarter we held $151 million; and when recent second quarter sales are ultimately recognized we are likely to be holding less than $90 million.

- Two years in, I feel good about the market for art and luxury goods. I am pleased with Sotheby's progress on its strategy but thrilled with options we can still explore.
    - Our technological prowess is still in its early days, but accelerating and our innovation rate is soaring.
    - The team is doing well and we are a great place for talent. Finally, we are using capital wisely and well.

- Before turning it over to Mike, I want to add one paradox amid all of this good news.

- Mike and I visit with investors the world over. Our current investors seem very happy with how things are going: support for our proxy thus far is strong again this year and we hear the same messages in our investor meetings.
- But persuading prospective investors to join our mission when they see our stock is at a multiple of 26x trailing Adjusted EPS* can make for an interesting conversation.
- So from management's perspective, why are Sotheby's future prospects attractive for investors today? Let me summarize the reasons I tell prospective investors:
    - First, Sotheby's underlying market includes a compelling secular growth trend of greater wealth accumulation at the high end, globalization and cross pollenating of cultural and luxury tastes, and intergenerational wealth transfers particularly in developed countries.
        - Let me pause for a moment to illustrate the secular effect of increases in wealth on the art market:
        - We compared the peak, median, and lowest wealth numbers estimated for the Forbes 400 in 2006 and 2016 versus the value of the most expensive piece of art and the total value of the top ten most expensive pieces of art in those same years.
        - The results were extraordinary. While the #1 and the #400 on the Forbes 400 were certainly interesting, the Forbes #201 was the one we used for the analysis.
            - In 2006, the 201st wealthiest person on the Forbes 400 would have had to spend 10% of his wealth to purchase the most expensive piece of art sold in auction that year; in 2016 that same number was only a little over 5%.
            - In 2006, the 201st wealthiest person on the Forbes 400 would have had to spend over 70% of his wealth to purchase all of the top ten pieces of art sold at auction that year; in 2016 that same number was under 40%.
        - In other words, the median member of the Forbes 400 would have seen his personal spending power to purchase art at auction grow 75% in the past decade alone.
    - Returning to the second reason why Sotheby's future prospects are attractive for investors: the industry in which we compete – the global market for art and other collectibles – provides Sotheby's with extremely

high entry barriers and, arguably recent regulatory and capital trends are raising them.

    - Third, technology acts as a force to power Sotheby's growth and reach, especially in the middle market.
    - Fourth, while Sotheby's is very seasonal and cyclical, and the stock can be volatile (with an estimated Beta of just under 2), our capital allocation and other initiatives seek to raise both the apex and the trough of the stock's historical cycle, and doing so would obviously make any particular entry point of the stock irrelevant to the long term investor.

- In summary, we have very good things happening for clients, investors and staff here at Sotheby's. We will have up quarters and down quarters. But we are confident in our story, our upward secular growth trajectory, and our strategy.
- Now I will turn it over to Mike for a specific review of the first quarter.

SPEAKER: Mike Goss, Chief Financial Officer

- Thank you, Tad.
- There is a lot of good progress to report in this quarter, starting with news regarding our sales levels and what such levels say about the health of the market.
- First, for the reported numbers. Our Net Auction Sales showed 3% contraction for the period, which everyone will recognize is a much improved statement relative to each of the four quarters of 2016.
- But this statistic doesn't tell the whole story. Interestingly, if you're looking to our sales for a sign of what is happening in the marketplace, it's informative to note three additional factors in this quarter which show an even better picture.
    - First, our Private Sales were up 41% for the quarter, the result of both a stronger market and the results of our internal efforts against this critical strategic initiative for future growth.
    - Secondly, our Net Auction Sales, which were reported down 3% on a dollar basis, were actually up 7% on a constant currency basis given the concentration of sterling denominated sales in London during the first quarter and the adverse change in the sterling to dollar exchange rates versus a year ago.
    - And finally, if you add together our Aggregate Auction Sales, our Private Sales, and the sale of our house property reported as Inventory Sales (which is sold both at auction and privately), you arrive at a number we reported in our filings

as "Consolidated Sales." This measure provides visibility into the broadest level of activity across Sotheby's, and in this regard, we reported growth of 13% in dollar terms and growth of 23% on a constant currency basis. It is this statistic that makes us feel much better about the state of the market going into 2017.

- With respect to our reported revenue, you'll see similar signs of encouragement, most notably the fact that our Agency Commissions and Fees were up 23% versus year ago. This growth is attributable to three factors:
    - First, an improvement in our Auction Commission Margin from 15.4% last year to 18.0% this year. Even if you exclude the impact of the final Taubman sale in last year's first quarter, our Auction Commission Margin still improved by 160 basis points, marking the fifth consecutive quarter of improvement.
    - Secondly, we wrote guarantees this year which generated much better financial performance than the guarantees associated with last year's first quarter sales, and
    - Finally, we reported higher private sale commissions in line with our higher private sales level.
- On the expense side, our Adjusted Expenses* (which excludes from our reported expenses the interest expense associated with financing our Sotheby's Financial Services loans and the cost of goods reported as inventory sales, as well as certain charges in the prior year) were up 8% year over year.
    - This increase was alluded to on our last earnings call as we expected to be making investments that drive our digital marketing initiatives, expand our advisory and private sales staffs, address new geographies, and acquire new customers.
- The net effect is that the stronger sales activity and better revenue margins in our Agency business overwhelmed the impact of our higher expense level and investment spending to help us deliver a 47% better Adjusted Operating Loss* in this seasonally low first quarter than we reported a year ago.
- From a balance sheet perspective, as Tad mentioned, we continue to focus on the generation of cash in order to redeploy this capital into more productive uses.
    - As evidence of this progress, we point out that our estimated Sotheby's cash balance, which we define as cash on the balance sheet less amounts due to consignors, is approximately $25 million higher than a year ago at this time despite having returned approximately $200 million since then to our shareholders in the form of stock buybacks. This was generated by our operating profit and better management of our balance sheet.

  - I should also point out that we still have almost $300 million in Sotheby's cash that is still being held abroad awaiting potential repatriation and for which the tax liability associated with this cash is already provided for but remains unpaid. Sotheby's hopes the federal government comes through with means for bringing this cash back pursuant to some type of "repatriation holiday", because the savings for our investors can be substantial.
  - Finally, I'm pleased to report that we recently completed a 10b-5 stock repurchase plan in which we purchased 740,000 shares of stock for nearly $34 million specifically to offset the dilution from recent grants under our long term incentive plan.
- As we head into the second quarter, we're anticipating improved performance from next week's New York Contemporary and Impressionist & Modern Sales, reflecting both signs of a stronger market and a continued focus on margins, and we're anticipating further progress in Private Sales as well.
  - However, we know we're up against last year's extraordinarily strong sales in Hong Kong and our record jewelry sale in Geneva last May.
  - We're also up against a very strong level of fees earned at Sotheby's Financial Services last year, and our June London sales will once again be translated back to USD at an unfavorable exchange rate.
  - Taken together, revenues generated by our strong North America spring sales may well be offset by tough comparisons elsewhere.
- On the expense side, we expect to continue to trend higher in Adjusted Expenses*, but as with our spending in this quarter, we feel such spending is justified in the pursuit of our strategic initiatives and our anticipation of the resumption of market growth.
- When taken together as a six month period, we continue to feel that the overall projection we provided heading into 2017 remains the same – that is, we are likely to show little, if any, EPS growth during the first half of the year but we will be well positioned if the market rebounds to historical levels of growth in the second half.
- 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 March 31, 2017 for an explanation of the non-GAAP financial measures used in this earnings call, as well as reconciliations to the comparable GAAP amounts.