

Sotheby's First Quarter 2019 Earnings Call Outline

May 2, 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 first quarter 2019 earnings release as well as the Company’s Form 10-Q for the period ended March 31, 2019. 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 we are reporting a first quarter 2019 loss per share of (\$0.15) compared to (\$0.12) per share in the prior period.
- After excluding certain charges, our Adjusted Diluted Loss Per Share* in the first quarter of 2019 was (\$0.15) compared to an Adjusted Diluted Earnings Per Share* of \$0.09 in the first quarter of 2018, a first quarter profit that has only happened a handful of times in the 30 years since we went public.
 - Our results in the first quarter would have been higher were it not for the rescheduling of certain Spring Hong Kong sales into the second quarter of 2019 after occurring in the first quarter of the prior year. The schedule change moved \$74 million in Net Auction Sales from our Wine and Contemporary Evening Sales in Hong Kong from the first quarter to the second quarter of 2019.
- Despite being a traditionally small quarter, we do hold several important sales in the period that provide us with important indicators about the state of the market.
- Let’s take a closer look at those results, along with a few sales that have occurred since then, before looking ahead to our important May auctions. I will then turn things over to Mike to review the financials in more detail before taking your questions.
- So far in 2019, we are encouraged by what we are seeing in our global salesrooms and the picture we see for the market.
 - While the overall supply of our sales was lower in some categories, demand and sell-through rates have remained strong.

- We began the year with our annual Masters Week auctions of Old Master paintings, drawings and sculpture in New York, which reached \$100 million for the first time in eight years with nearly 50% of the sold lots achieving prices above their high estimates.
 - Our Evening Sale brought a total of \$52.7 million and featured a group of works created by leading female artists from the 16th through the 19th centuries. Titled *The Female Triumphant*, the offering totaled \$14.6 million and established new auction records for seven female artists.
 - The series also included an auction of Old Master Drawings that achieved an exceptional \$15.1 million, the highest ever total for any such sale at Sotheby's.
- Moving to London at the end of February and beginning of March, our Impressionist, Modern and Contemporary Art sales brought a total of \$287.6 million.
 - Despite macro concerns that affected supply and yielded an overall total smaller than last year by 28%, both Evening Sales achieved healthy sell-through rates of 91%.
 - The series was led by Claude Monet's Venetian view that sold for \$36.2 million against the \$25 million low estimate in our Impressionist & Modern Art Evening Sale.
 - Asian collectors were particularly active in that sale – we saw a 50% increase in bidders from Asia compared to the prior year.
- Those auctions were immediately preceded by outstanding results achieved by our Contemporary team in New York: a \$36.8 million Contemporary Curated sale, the highest ever total for the series.
 - The sale was led by the second highest price ever achieved at auction for Kerry James Marshall – \$7.3 million paid for the artist's *Untitled (Painter)*, which soared past its \$2.5 million high estimate.
- In mid-March, our Asia Week sales in New York brought an overall total of \$45.7 million, with five works surpassing \$2 million. These results were 42% lower than the same series in 2018 largely due to a number of single-owner consignments that were not repeated this spring.
 - The top lot of the recent series was a rare and extraordinary handscroll – *Poems on Falling Flowers in Running Script* – that achieved \$3 million in our sale of Fine Classical Chinese Paintings & Calligraphy.
- As I mentioned earlier, our major spring auctions in Hong Kong straddled our first and second quarters.
 - Ignoring for a moment how these sales occurred between the two quarters, the results were superb:

- The six-day series brought a net total of \$397.7 million against a low estimate of \$298.2 million. Including the buyer's premium, the aggregate total reached \$482 million, the second highest total in company history.
 - We saw a healthy overall sell through rate of 90% with competition across all categories and from all corners of Asia.
 - The results were particularly strong in the Modern and Contemporary Art categories, which bode well for our upcoming sales in New York in twelve days' time.
- Before we turn to our upcoming auctions, a word on Private Sales.
 - We continue to be very pleased with our Private Sale performance.
 - While our first quarter total is down compared to the same period last year, that is attributable to a handful of high value transactions we concluded in the first quarter of 2018 that weren't repeated this year.
 - The good news is that we closed several significant private sales early in the second quarter of 2019, so we expect the six-month picture to reflect our continued success in this area.
 - Nonetheless, a reminder that Private Sales by their very nature can be unpredictable and results can vary from quarter to quarter; but in the long-term, we expect continued secular growth.
- Turning now to our important auctions this month:
 - We open with our Impressionist & Modern Art Sales, which carry a low estimate of \$305.5 million and begin with the Evening Sale on May 14th. These sales are slightly smaller than our sales in May 2018, which is impressive given that we had one work sell for \$157 million this time last year.
 - The upcoming sale is led by one of the finest examples of Claude Monet's renowned Haystacks series. The painting is from a group of 25 canvases created by the artist in 1890 and is one of only four to come to auction this century.
 - The work has remained in the same private collection since it was acquired by the present owners at auction in 1986 and is estimated to sell for more than \$55 million.
 - The sale will also include a portrait by Pablo Picasso of his second wife Jacqueline that was completed over the course of a month at the end of 1962.
 - Consigned by a Japanese Private Collection, the painting is estimated to sell for \$25/30 million.
 - Our Contemporary Art Evening and Day Sales have an overall low estimate of \$326.3 million and will begin on the evening of May 16th.

- Among the highlights of the Evening Sale are two paintings with distinguished provenance being sold to benefit important cultural organizations.
 - Mark Rothko's *Untitled, 1960* is being sold by the San Francisco Museum of Modern Art to benefit the institution's Acquisitions Fund and is estimated to sell for \$35/50 million.
 - *Study for a Head* from 1952 is one of the most important paintings by Francis Bacon remaining in private hands and carries a pre-sale estimate of \$20/30 million. The painting is from the collection of Richard E. Lang and Jane Lang Davis, which now belongs to the Friday Foundation, a private charitable organization.

- As a reminder, tomorrow we are opening completely reimagined galleries in our New York headquarters and I encourage all of you to visit us over the next two weeks.
 - With limited capital investment, we have added more than 20,000 square feet of exhibition space. We now have 40 galleries of varying sizes spread across four floors and we accomplished this without disrupting our business.
 - In fact, we conducted sales of \$1.34 billion in New York over the past 11 months while the construction project was quietly underway, sealed behind temporary walls.
 - In addition to our major sales of Impressionist, Modern and Contemporary Art, we will have an array of works on view ranging from 20th Century Design to floral jewels from the 19th century to the present.

- Looking beyond our auctions, we are equally encouraged by the progress we are seeing across all of our digital initiatives.
 - In the first quarter of 2019, the number of online buyers across our business – in our live auctions, as well as online-only sales – was up 18%, the number of lots sold online was up 43%, and the total dollar amount sold to online buyers was up 23% compared to the same period in 2018.
 - The number of online-only sales we held in the first quarter of 2019 grew by 64% with overall sales growth of more than 100% compared to the same period one year ago.

- On the digital sourcing side, the first quarter yielded equally encouraging indicators.
 - In the first quarter of 2019, the number of items submitted through our online estimate platform grew 69%, the number of items we estimated increased 96%, the number of items consigned for sale (auction or private) was up 113%, and the number of sold lots rose 89%, compared to the first quarter of 2018.

- Additionally, consignments through the platform contributed 30% of the net auction total of a recent sale of Watches including a top lot – a Rolex– that sold for more than \$250,000.
- In short – good quarter, good indications about things to follow, and we are on track.
- I will now turn it over to my colleague Mike to go through our financials before we take your questions.

SPEAKER: Mike Goss, Chief Financial Officer

- Thank you, Tad.
- One of the most important factors to understand when looking at the results for the first quarter of 2019 is the fact that our Hong Kong Spring Sale Series occurred on a different schedule between the first and second quarters than they did last year, with more of our sales this year occurring during the second quarter.
 - As we heard from Tad earlier, the overall series was very successful in the aggregate – the second largest in our history and up 4% versus last year’s great sales – but if you consider how these sales occurred by quarter, we reported Hong Kong’s Net Auction Sales in the first quarter that were down 7% versus last year and in the second quarter they were higher by 9% versus last year.
 - Of course, what is bad news for the comparison in the first quarter is good news for the comparison in the second quarter. This also serves as another reminder why we always encourage investors to consider our rolling six month results as importantly as they consider our quarterly results.
- As for the rest of our results, the quarter played out generally as we had anticipated during our last earnings call when we acknowledged we were likely to return to a loss for the first three-month period of the year, more in line with our historical pattern of first quarter losses.
- One particular piece of promising news is that we’re encouraged by the first quarter’s 18.2% Auction Commission Margin, which was up 90 basis points versus the margin one year ago.
 - For the trailing six-month period ended in March, our Auction Commission Margin improved from 17.1% a year ago to 17.4% this year. As importantly, by the time we get to June and we are looking back at the first half of 2019, we expect to see even more improvement on a year-over-year basis.
 - You might recall, on our last call together, we expressed optimism that we might see a slight strengthening of our Auction Commission Margin in 2019 after experiencing pressure at mid-year in 2018, so the outlook remains positive on this front.

- So, what can we say about the second quarter?
- Clearly, we enter the quarter with two significant tailwinds: the favorable comparison we've already seen in Hong Kong and a promising outlook for the all-important New York sales in two weeks.
 - In addition, we're also comparing against a quarter a year ago with the two large paintings that significantly impacted our profitability last year.
 - Without having comparable risks this year, or said another way, with a largely hedged guarantee exposure and relatively few high priced, high risk paintings in this year's auctions, we believe we're on track for a strong second quarter comparison to last year.
- We're also confident that once we report the June quarter and we are looking back at our business on a trailing six-month basis at that time, we'll see a company with a stable to moderately growing and profitable base business along with even more promising signs from our major ecommerce initiatives.
- Let's now hand things back to the moderator for your questions.

* Non GAAP financial measure. See Appendix B to the first quarter 2019 earnings release as well as our most recently filed 10-Q for the period ended March 31, 2019 for an explanation of the non-GAAP financial measures used in this earnings call, as well as reconciliations to the comparable GAAP amounts.