Sotheby's Third Quarter 2018 Earnings Call Outline
November 1, 2018

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 third quarter 2018 earnings release as well as the Company's Form 10-Q for the period ended September 30, 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

- Good morning, and thank you for joining us.
- Today, we are reporting a third quarter loss per share of ($0.55), worse by 22% compared to ($0.45) in the prior year period. After excluding certain charges in the current period, however, Adjusted Diluted Loss Per Share* improved 9% from ($0.45) in 2017 to ($0.41) in the current quarter.
- For the nine month period, diluted earnings per share is $0.43 compared to $0.78 in the prior period. After excluding certain charges in both periods, Adjusted Diluted EPS* improved 1% from $0.79 in 2017 to $0.80 in 2018.
- As Mike Goss will explain later in the call, the quarterly comparison is even better when one takes into consideration the $7.4 million benefit reported in the third quarter of 2017 for the reversal of a tax reserve, which provided a $0.14 per share benefit at this time last year.

- I will start with an update on the market as well as look ahead to what we can expect from the fourth quarter, and close with how we are thinking about technology, before handing things over to Mike.
- Given the few sales we hold in the third quarter, we look to our nine month figures to get a sense of where we are:
    - Consolidated Sales – which combine Aggregate Auction Sales, Private Sales and sales from our Inventory – increased 20% for the nine month period to $4.04 billion.
    - Private Sales are up 49% to a total of $675.4 million.
- In terms of recent data points to consider – at the end of September and into the first week of October, we held our semiannual sales in Hong Kong, which provided valuable information about the health of the market and the mindset of our clients across Asia.

    - The sales had a number of significant highlights, including a monumental modern painting by Zao Wou-Ki that sold for a record $65 million, two porcelain masterpieces that sold for close to $20 million each, and a rare 100% sold Contemporary Art Day sale, to name a few.
    - In the Modern and Contemporary Art categories, both the number of buyers and aggregate spending were up sharply, including from Mainland China, also with particular strength from Taiwan and Hong Kong, which could bode well for our upcoming New York auctions in the same categories.
    - In summary, our Hong Kong sales series totaled $466.1 million, which was a 15% increase year-over-year and virtually flat with the April 2018 series, which was itself the second best result in our history.
    - Overall Asian buying in those sales rose 12% in value, which was led by great strength in Taiwan, stability in Hong Kong, and a decline of 14% from Mainland Chinese buyers, a weakness that showed up particularly in categories such as Chinese Works of Art, traditional Chinese paintings, and jadeite jewelry.
- In the first week of October, we also held our annual Contemporary Art auctions in London alongside the Frieze Art Fair.
    - Our Evening and Day sales, including 50 works from the collection of David Teiger, achieved an aggregate total of $109.2 million against a low estimate of $82.7 million, just below our total for the same series held in October 2017.
    - The sales were led by one of the most important paintings by a British artist of the last thirty years – Jenny Saville's *Propped* – which established a new auction record for any living female artist when it sold for $12.4 million after a battle between eight bidders.
- Our recent Wine auctions in Hong Kong and New York are also worth mentioning – the Hong Kong series totaled $14.5 million with a combined sell-through rate of 99%. The New York sales were similarly strong, achieving a total of $12.3 million and setting a new world auction record for any bottle of wine.
    - Those sales bring our year-to-date total for wine to $88 million, a 77% increase compared to the same period in 2017.

- Looking ahead to New York and Geneva, we are very pleased with what our teams have assembled.
- With respect to the market conditions, there are uncertainties, including political noise here and abroad, as well as rising interest rates and slowing global growth.
- Despite these data points, we remain cautiously optimistic about our prospects for November in New York and Geneva due to the strength, superb selection, attractive pricing, and freshness of our works.
- Our Impressionist & Modern Art Evening and Day Sales on November 12th and 13th carry a combined low estimate of approximately $320 million, a 25% increase compared to our net totals from one year ago.

- Among the highlights is one of the world's finest private collections of Fauve, Expressionist and Modern works that is estimated to achieve more than $90 million.
- The team put a lot of thought into crafting a dynamic sale that would look different than others on the market this season.
  - One dimension of that strategy is a curated selection within the Evening Sale focused on the tremendous and varied impact of the First World War on the artistic production of those whose lives it transformed – just as we are about to acknowledge the 100-year anniversary of the Armistice.

- The combined low estimate of our Contemporary Art Evening and Day Sales on the 14^{th} and 15^{th} of November is $323 million, just slightly below our net totals from November 2017.
  - The auctions include major canvases by Gerhard Richter, Georgia O'Keeffe, Christopher Wool, David Hockney, and four works by Jean-Michel Basquiat.
- Our auctions of Impressionist & Modern and Contemporary art in New York are complemented by an extensive offering of works available for private sale.
  - We have assembled about $250 million in works by a range of artists including Joan Mitchell, Alexander Calder, Georges Braque and Marc Chagall that are available for immediate purchase.
- Turning to Geneva – we begin with our sale of Important Watches on November 13^{th}, which carries a low estimate of $10.2 million, a more than 100% increase compared to the results of the same sale a year ago.
- The low estimate for our Magnificent Jewels & Noble Jewels on November 15^{th} is $86.2 million, which is about 10% higher than our net total from last November.

- Next, let me address the emerging picture for 2019. We are at the beginning of our planning process for next year and will certainly know more after our major November sales.
- Nevertheless, we are planning for market conditions in 2019 to be a bit more subdued than what we experienced at the end of 2017 and into early 2018.

- Turning now to our technology strategy, we are building a company that will endure and grow beyond the boundaries of its historical value.
  - The elements of this technology strategy and investment are (1) digital infrastructure; (2) data; (3) basic services; (4) enriched content with enhanced reach; (5) advanced services; and (6) blockchain-enabled innovations.

- First, we have been investing in what we call our "digital infrastructure".
  - After two years of work, next year we plan to have all auctions migrated to a new auction engine as well as to have a paperless auction room, with resultant improvements in client service, speed, and cost reduction.

  - In addition, we recently replaced our outdated content management system with a new one having significant benefits in terms of stability, depth, search optimization, and the potential for innovation.

- Second, we have access to a number of different collections of data on valuable objects, provenance, title, authenticity, ownership, pricing, buyer preferences and behaviors, and sales transactions.
  - We have also added data from the acquisition of the Mei Moses Index in late 2016, the dramatic expansion of our customer relationship management marketing over the past two years, the promised and now nearly-completed investment in an object database to facilitate private sales execution, as well as the enormous growth in our social media capability.
  - However, these data have been fragmented throughout the company, not easily accessible, and not harnessed fully for innovation.
  - Earlier this year we began to collate, clean, centralize and standardize this data, establishing a foundation for powerful machine learning and other products that will greatly enhance our ability to serve our clients. We expect the fruits of this to begin to show up next year.

- Third, we have been investing in what we call "basic digital services" over the past three years.
  - These basic services include a beautifully refreshed public website, and a mobile app – launched in 2016 – that has been subsequently upgraded with capabilities now including access to preferred benefits, credit card payments, complete catalogue materials, condition reports, and the beginning of mobile bidding for our single owner online-only auctions, with various owner sales to follow next year.
  - We have also upgraded and enabled our retail wine store for e-commerce as well as purchased Viyet, re-launched last month as Sotheby's Home, to give us a first rate, low touch retail capability for non-auction transactions.
  - As we turn to the future, our investment program will gradually migrate from these basic services to the more advanced innovations that can propel outsized future growth.

- Fourth, part of creating a great experience for clients is to develop and distribute rich and engaging content.
  - Our new content management system, mentioned earlier, has given us the ability to surround clients with a growing menu of deep content to enrich their discovery, purchase, or sale of valuable objects.
  - Thus far this year, our media team has produced and distributed more than 1,500 original pieces of editorial content, including 315 videos, viewed over 20 million times. More than 15,000 visitors who engaged with this content registered to bid in our auctions, and a similar number requested estimates for consignments.

    - New artist pages on our website give a perspective on more than 140 of the most-searched-for artists, in many cases, with a Mei Moses snapshot of the recent price performance of their works and the associated holding period, as well as a selection of ‘related artists’ to explore.
    - Total video views across all of our platforms is up over 100% from last year, one of the key reasons that we are on track to end the year with a more than 40% increase in unique visitors to our site and a 20% increase in total site traffic.
    - In social media alone, for example, we are 65% larger than the next competitor and our reach includes Facebook, Instagram, Weibo, Twitter, and WeChat.

- Fifth, we have been piloting a range of even more advanced digital services that will serve as a platform for future growth.
    - We announced our online consignment tool in March 2017. So far this year, we have sold more than $30 million in items submitted via this tool, with an average buyer’s premium of 22% and a wonderful average vendor’s commission of 5%.
    - And the growth of this tool is very exciting. In October, we received approximately 7,500 submissions, which is 20% over the prior month.
    - Obviously this level of growth requires that we create new service models using technology and more flexible staffing processes to satisfy our exploding demand.
    - Through a better mobile and web user interface, which we call Appraise – expected to be launched next year – we plan to scale this growth and serve as a platform for consignors who want to transact quickly, easily, and conveniently.
    - Another more advanced service is the recommendation engine that we have been piloting internally and testing on our artist pages.

- It would be hard to discuss technology in luxury markets without commenting on blockchain.
- Clearly, blockchain poses opportunities for the art market and we here at Sotheby’s are taking the technology very seriously.
    - Let’s begin by noting that an immutable distributed ledger technology with independent attestation combined with security, convenience, and low cost would be a powerful enhancement to reducing art transaction costs and enhancing the velocity and dollar volume of global art asset turnover.
    - We see several critical roles for Sotheby’s to play in such a market structure:
        - Seeding the distributed ledger with crucial data to make it easy for client adoption; providing branded, and potentially legally binding attestation behind aspects of the data such as provenance, title transfer, authenticity, and attribution; assembling or teaming up with partners to catalyze widespread trial and adoption; and appending services to the core ledger that allow clients to maximize the value, increase the enjoyment of, and reduce the cost of owning their valuable objects.

    - We are well underway assessing and implementing this vision and will have additional announcements in due course.

- As we have said before, not all innovations are technology related.
- We are five months into our construction project for our new gallery space on floors 1-4 of our Manhattan headquarters and are on target to unveil the finished product next April.
    - We have completely reimagined the existing public spaces on those floors, and repurposed significant space that had not been adequately deployed previously.
    - The result will be vibrant new galleries that will provide us with opportunities for more events and exhibitions throughout the year, particularly around our major sale moments, as well as new special guest exhibitions.
    - In addition, both our Paris locations and our London locations are completing improvements to make their gallery space larger and more inviting for clients.

- Regarding innovation as it relates to talent, we continue to look for ways to engage our employees and make Sotheby's a best-in-class place to work.
    - In March, we granted all eligible employees restricted stock units, representing shares of Sotheby's common stock, and we are looking forward to this March and the first vesting event, making all of our colleagues owners of Sotheby's.
- Just last week, we announced the launch of a new student loan repayment benefit program aimed at easing the burden of our employees, which will enable employees to repay their student debt – college or graduate – more quickly by supplementing their regular payments with monthly contributions from Sotheby's.
    - And the program covers our employees for as long as they remain an eligible full-time United States-based employee of Sotheby's with qualifying student loans.
- Our colleagues are our company's greatest strength and their engagement and satisfaction are paramount in the value we deliver for our clients and shareholders.

- I will now turn it over to Mike to go through our financials before we take your questions.

SPEAKER: Mike Goss, Chief Financial Officer

- Thank you, Tad.
- As most of you are aware, the third quarter is always a quieter one, and clearly the smallest of our four quarters as we hold fewer sales in the summer– for example, for the trailing twelve months, this recently completed third quarter accounted for only 9% of our Net Auction Sales. We recorded a loss for the period, which is not surprising given our highly seasonal business.
- The most important news from our third quarter is what it tells us about the environment as we head into the all-important fourth quarter – a quarter that last year produced 65% of our annual earnings, and in stark contrast to the third quarter, is usually our most important.

- Before I address our outlook for the fourth quarter, let me first call attention to just a few points from our announcement this morning:
    - Our Net Auction Sales were up 30% versus the same quarter last year with almost all the growth resulting from an evening of exceptional Modern and Contemporary sales held at the start of our Hong Kong Sales Week.
    - Our Adjusted Expenses* rose only 2% for the quarter compared to increases of 13% in the first quarter and 8% in the second quarter confirming our prior indications that the growth in these expenses would moderate over the course of 2018 as we start comparing to periods that already reflect our strategic investments in technology and innovation.
    - As a result of the strong sales and more moderate expense growth, our Adjusted Operating Loss* for the quarter improved significantly from ($41 million) last year to ($27 million) this year.

    - These factors translate into a slight improvement in third quarter Adjusted Diluted Loss Per Share* to ($0.41) despite two factors which hurt our comparison to last year:
        - First, as Tad mentioned earlier on in the call, last year's third quarter included a significant benefit for the reversal of a tax reserve that favorably impacted last year's per share calculations by $0.14.
        - Secondly, because of our aggressive share repurchase program, this year's third quarter loss is spread over 50.9 million shares versus the 52.5 million shares we had last year. Put another way, if we had 50.9 million shares outstanding last year, our third quarter 2017 loss per share would have been a little over $0.01 higher.

    - It's a good time to pause and reflect on our stock buyback program. Through the end of the third quarter, in 2018 we have repurchased almost 3.8 million shares (which does not include any "true up" share amount for the ASR plan we did in mid-September) for slightly more than $195 million. Going forward, we continue to expect to return capital to shareholders through stock buybacks. After we complete our recent $95 million Accelerated Stock Repurchase Plan, we may review with the Board an additional authorization, particularly given our assessment that we will still have approximately $250 million in excess capital that we mentioned on our last earnings call.

- Now let's move to how investors should view the upcoming quarter.
    - Remember, the Hong Kong Modern and Contemporary Sales that took place in the third quarter were up 117% or $84 million. However, this was partly counter-balanced by weaker sales that followed, which were down 18%.
- Therefore, we are not encouraging investors to add any over performance in the third quarter to their previous expectations for the full year.

* Non GAAP financial measure. See Appendix B to the third quarter 2018 earnings release as well as our most recently filed 10-Q for the period ended September 30, 2018 for an explanation of the non-GAAP financial measures used in this earnings call, as well as reconciliations to the comparable GAAP amounts.