Sotheby's Second Quarter 2018 Earnings Call Outline
August 6, 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 second quarter 2018 earnings release as well as the Company's Form 10-Q for the period ended June 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

- Thank you for joining us this morning.
  - Today we are reporting second quarter diluted 2018 earnings per share of $1.08 compared to $1.43 per share in the prior period, and for the first six months of 2018, $0.95 per share compared to $1.21 per share in the prior period.
  - After excluding certain charges in both periods, our Adjusted Diluted Earnings Per Share* in the second quarter of 2018 was $1.09, compared to $1.44 in 2017. And for the first half, Adjusted Diluted Earnings Per Share* was $1.18 versus $1.22 in 2017.

- Overall, these results were lower than we expected. At the same time, Management and the Board are as excited as ever about the Company's prospects going forward, and I will spend some time on explaining why before turning the call over to Mike for a financial review.

- Let's begin with our assessment of the marketplace.
- Generally speaking, the market is clearly healthy.
  - The second quarter saw an enormous amount of property come to market.
  - In the big May and June sales, fresh pieces that were correctly priced did extremely well in the auction room.
  - However, much of the growth in the quarter was attributable to a few large, competitive, fiduciary driven consignments that tend to carry lower margins.
    - In addition, with respect to a couple of the season's high value lots, there appeared to be a bit less bidding than a year ago, both here and elsewhere. The result of these two factors was reflected in our Auction Commission Margin, which Mike will cover in greater detail later in the call.

- Against this market backdrop, we performed well from a sales perspective:
    - Consolidated Sales – which as a reminder are a combination of our Aggregate Auction Sales, Private Sales and sales from our Inventory – increased 15% to $2.4 billion in the second quarter of 2018, and 22% to $3.5 billion in the first half of 2018, right in line with the highest totals in our company's history.
    - Private Sales continued its recent performance of doing very well – up 57% in the second quarter to $296 million, and 63% to $543 million in the first half of 2018, versus the same periods a year ago.
        - Our enhanced focus on this area of the business, together with a stronger organization and better tools, have clearly begun to have a beneficial effect.
    - Approximately 80% of the more than 23,000 lots offered in the first half of 2018 sold, continuing our strong performance on behalf of our consignors.
    - We continue to grow the number of new buyers at Sotheby's:
        - In the first half of 2018, approximately one third of total buyers were new to the Company, and
        - 19% of our total hammer in that same period came from new buyers, which is up five points from the prior three years.
    - Asia also continues to be a success story– our Aggregate Auction Sales in Asia for the first half of 2018 totaled $488 million, up 15%, and with a strong sell-through rate of 90% and 21 world auction records set.
        - We continue to lead the market across critical categories including Chinese Works of Art, Modern & Contemporary Art and Chinese Classical & Modern Paintings.
        - Equally important is the impact of Asian clients felt not just in Hong Kong, but in our New York, London, Paris and Geneva salesrooms.
            - In the first half of 2018, Asian clients accounted for 28% of our Aggregate Auction Sales and purchased eight of the top 20 lots sold at Sotheby's year-to-date.
        - We are also encouraged by the growth of new clients – in the first half of 2018, 28% of buyers were new to Sotheby's Asia and, coincidentally, 28% was also the growth rate of Asian clients buying Western art.

- As you know from prior earnings calls, we have been investing to sharpen the differentiation between Sotheby's and other competitors, as well as to grow our business.
- What has this investment been buying at Sotheby's?
    - After over a year of work, the first item this has brought to us is much better tools for Private Sales.

  - Secondly, the investment program has replaced our old and poorly functioning content management system with a new one that has the capacity to enhance our selling experience for clients and dramatically improved our search optimization.
  - Third, we are also implementing advanced Customer Relationship Management techniques to increase our sell-through rate.
  - Fourth, our mobile capabilities and digital plumbing to support online bidders and sellers have made huge strides and are months away from a full rollout of significant innovations in terms of payments, user experience, security, speed, and cost reduction.
  - Fifth, our efforts to use advanced technologies that make online consignments friendly, easy, and quick are a key area of our focus, and we are encouraged at our near term progress.
  - Sixth, our efforts to make the auction room paperless are well on track and should be rolled out next year, with efficiencies to follow.
  - Last, our marketing programs have made the leap over the past few years from analog and paper-based to digital and smart, with the recognition that great content drives better commerce.

- When will all of this pay off?
  - It already has begun to do so. Versus the first half of 2017, our performance statistics in the first half of 2018 show real progress:
    - Online sales are up approximately 30% versus last year, totaling a little more than $100 million.
    - Lots sold online are up 19% to a 25% share of the total, versus 21% share last year.
    - Online bidders are now 45% of the total, up seven points from last year.
    - Online buyers are now 32% of the total, also up five points from last year.
    - The number of online-only sales staged is equivalent to the whole of 2017, with as many as 40 additional sales planned for the balance of the year.
    - Revenue from middle market property is up nearly 9% versus last year.
    - Number of mobile users is up 39% versus last year.
    - Social media reach is greater than the closest competitor by more than 50%.
    - Video views are up 100% year-over-year.
    - Editorial content production is up by 46%, and 40% of all registrants consumed our editorial content as part of their transactional journey so far in 2018.
      - Our continued digital growth – including total site traffic, unique visitors, social audience, and editorial consumption – is important not only from a buying and selling perspective, but it also allows us to attract new audiences – who are increasingly discovering our content through search

engines and social media – something that is particularly relevant to developing our middle market categories.

- Not all innovations, however, come from technology. For example, we have an exciting renovation project underway at our New York offices that will expand our historical gallery space from 67,000 square feet to 90,000 square feet.
    - When finished next April, we will have enough space to put our next two competitors into our galleries with room to spare, which will enable us to provide a powerful marketing advantage for consignors.
        - Our new exhibition space will also exceed that of major institutions, including The Broad, the Whitney Museum of American Art, and The Uffizi Gallery.
    - And even before then, our current 48,000 square feet of untouched and beautiful exhibition space remains larger than that of our next largest competitor this autumn.
    - Moreover, our London and Paris colleagues are sprucing up their own galleries in a more limited fashion.
- Finally, I would like to touch on the company's capital allocation since using capital more efficiently has been a major area of focus for the company over the past few years.
    - For example, our inventory balance in the most recent quarter was $32.6 million versus $74.5 million at the end of 2017 and $215 million at the end of 2015.

- Thanks to efforts like this, Sotheby's is flush with liquidity right now, and given the enthusiasm by the Board and Management about Sotheby's prospects, we will likely take advantage of our $133 million in unused authorization to repurchase our stock over the coming quarters.

- 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.

- Just as a quick reminder, when looking at this year's second quarter results, one needs to consider the shift in the timing of certain Hong Kong sales from the second quarter in 2017 to the first quarter in 2018.
    - Recall we reported $130 million in Net Sales and approximately $20 million in operating profit in the first quarter of 2018 for sales that occurred last year in the second quarter, making for a tough comparison for this year's second quarter. This is a vivid reminder that you should always consider the trailing six month period to fully understand what is going on in the business.

- With respect to our Auction Commission Margin, which came in below where we would have liked to see it, Tad mentioned several of the factors driving the comparison, namely the heavy mix of competitive, fiduciary driven and charitable estate sales, and a couple of high value paintings that performed below our expectations.
    - To quantify the issues, of the 170 basis points decline in Auction Commission Margin from 1H17 to 1H18, a full 110 basis points of the decline was attributable to the sale of two large guaranteed paintings. The balance of the difference was due to the higher sharing amount typically required to win the large estate-style consignments.
    - For most of our collecting categories, and for the overwhelming majority of our sales, we were flat on a year-over-year basis at very attractive levels.

- With respect to our Adjusted Expenses*, we are indeed seeing the moderation we discussed at the end of 2017 with a much lower rate of growth for the second quarter as we were up 8% versus last year, compared to the 13% year-over-year increase in the first quarter.
- Despite being roughly where we expected to be in total, there is spending that can be eliminated, some of which will represent savings as a result of the digitization discussed earlier.
    - In particular, we can operate from a logistical and market coverage point of view much more leanly, and we have reassessed which marketing initiatives make the most sense for us.
    - As a result of this review, we and our colleagues are eliminating more than $20 million in annualized planned expenses, and neither our business nor our growth will be affected by these changes.

- In terms of the balance sheet, we continue to manage our capital more efficiently, but with the necessary prudence to support the demands of the business. We estimate that we have approximately $400 million in excess capital, including the $133 million remaining on our previously approved, but unspent, authorization to buy back stock.
    - Part of this extra capital has been generated by the refinancing of our asset based borrowing facility in late June. Even while improving our interest rate by 25 basis points, we also managed to enhance the inclusions in our borrowing base by close to $145 million and we liberalized our covenant package to allow for greater flexibility in how we manage our business and how we deploy our capital.
    - Another part of our capital allocation story, which is often overlooked, is the extent to which we have reduced our leverage even while buying back over $467 million worth of shares since the end of 2015. At that time, we were carrying over $1.1 billion in total debt and we had only $232 million in undrawn credit.
        - Today, we are carrying approximately $725 million in debt and we have undrawn credit of almost $600 million, demonstrating the strong free cash flow generated by our business. Clearly, we have all the capital we need

to continue funding our business and returning handsome amounts to our shareholders.

- Looking forward, this year's third quarter will see little in the way of auction activity – such is the natural rhythm of our business – so we are focusing on our big fourth quarter sales. I also urge that when everyone is looking at this year's third quarter, you remember we had an unusual $0.14 per share tax benefit in last year's third quarter that won't be repeated this year.

- Looking longer term, all of our strategic growth initiatives remain on track, and the results of our improved capital allocation policies are proving to be as impactful as ever. Our team here is as enthusiastic about the future as they've ever been.

* Non GAAP financial measure. See Appendix B to the second quarter 2018 earnings release as well as our most recently filed 10-Q for the period ended June 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.