Sotheby's Fourth Quarter 2017 Earnings Call Outline
March 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. 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 an appendix to the earnings release filed earlier this morning. 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 us this morning.
  - We had a very good year in 2017, and are planning to have an even better one in 2018. The 1937 Picasso we sold for $70 million in London last night is certainly a pleasing indicator for the year ahead.
  - Today we are reporting 2017 earnings per share of $2.20 compared to $1.27 in the prior period, a 73% increase. After excluding certain charges in both periods, Adjusted Diluted Earnings Per Share* improved 32% from $1.71 to $2.25.
  - For the fourth quarter, diluted earnings per share is $1.43 compared to $1.20 in the prior period, a 19% improvement. After excluding certain charges in both periods, Adjusted Diluted EPS* increased 9% to $1.47 from $1.35 one year ago.
    - You may recall a change in our sales schedule that resulted in $82 million in Net Auction Sales from our autumn Hong Kong sales series falling in the third quarter of 2017, which may have reduced our fourth quarter results by as much as $0.15 per share.

- Three years in, we thought to look back on 2017, remind our stakeholders of our four key priorities, describe progress against them, and where we are headed in the future. I will close with an outlook for 2018 before turning it over to Mike Goss for a review of the financials.

- Our business achieved many milestones in 2017:
  - We set new records for any diamond or jewel with the CTF Pink at $71.2 million, and Chinese ceramic with the rare Ru brush washer for $37.7 million;

- We opened beautiful new premises in Geneva (where we also celebrated our 40th anniversary), and Dubai (where we also held our first auction);
- We also celebrated 100 years on New Bond Street in London and ten years in Moscow;
- Our March Impressionist & Modern sale set a new record for any auction ever held in London with a total of $240.8 million, and in November we broke a 27-year-old record for Marc Chagall with a painting that had remained in the same collection for 90 years and sold for $28.5 million;
- We captured the world's attention in May when Jean-Michel Basquiat's 1982 masterpiece set a new world auction record for any work by an American artist, selling for $110.5 million to the Japanese collector Yusaku Maezawa (and for those of you in New York, I encourage you to visit the Brooklyn Museum to see the painting, where it is on loan until March 11th) ;
- We set new records for an English car with a spectacular 1956 Aston Martin selling for $22.6 million, and an English Watch with George Daniels' Legendary `Space Travellers' Watch for $4.3 million;
- Our Old Master team successfully brought to auction a number of rediscovered masterworks by artists including Sir Peter Paul Rubens and Joseph Wright of Derby, and sold a major work by Parmigianino to the J. Paul Getty Museum privately;
- Our traditional sales of African & Oceanic art saw a new auction record set for any Easter Island work at $4.6 million, and outstanding results of $7.1 million achieved for the stunning Silver Collection, and we held our inaugural sale of Modern & Contemporary African art, setting a new record for an auction in the category with a total of $3.6 million;
- We presented the collection of celebrated French interior designer Jacques Grange, which far exceeded our high estimates with a total of $33.3 million and set a new record for a single owner sale at Sotheby's in Paris;
- Finally, the outstanding total of $26.4 million for our December 20th Century Design sales in New York was more than double that of our competitors combined.

- While strong, the sales achievements are only part of the story. Our operational statistics for the full year 2017 show that we are growing and thriving.
    - Our consolidated sales grew 12% in 2017, with 18% growth in the fourth quarter;
    - Note that the following statistics include auction and private sales but exclude wine:
    - We conducted more than 300 auctions and offered more than 50,000 items for sale, a 6% increase over 2016;

    - Our sell through rate improved by two points over 2016 to 80%, with the increase occurring across each of our major categories;
    - The average value of a lot rose 5%, but the crucial metric of hammer price versus low estimate soared 8 points to 110% versus 2016;
    - We were also pleased to see that the core of the middle market, lots between $100,000-$1 million, which is approximately 9% of our lots and 27% of our sales, grew 4% in lot terms and 9% in value terms in that very profitable category.
    - The number of our transacting clients rose 10%, with sellers up 6%, buyers up 13%, and bidders up 11%. First time bidders were also up 7%;
    - Even without a team in place for the full year, or the implementation of our new tools, private sales grew 28% in 2017 to $744.6 million, the best performance in four years;
- Thank you to my colleagues for their successful work.

- Turning to 2018, let's revisit progress against our four key priorities and review progress against them. As a reminder, the four priorities are as follows:
    1. To develop and implement a compelling growth strategy
    2. To embrace technology and increase the pace of our company's innovation
    3. To allocate capital wisely and efficiently
    4. To create a winning team that sustains the other three priorities

1. Our strategic ambition is that "Sotheby's be the best choice for clients to discover, buy, and sell the world's treasures." How are we doing?

    - Three years ago we set out to re-establish ourselves as the best place to discover, buy and sell fine art, and I believe that we have delivered on that objective.
    - Crucially, Sotheby's strategy is not to be the "biggest" market share player – although many times it turns out that we do have the largest sales – nor to be the 'cheap' consignment deal.
    - Instead, we aim to be the "best choice" for those clients who care about service excellence and overall financial performance, and then to deliver that performance over and over again.
    - Another strategy we had in early 2015 was to deepen and broaden our focus geographically around the world to be closer to those clients who could benefit from Sotheby's.

- We made good progress in East Asia, South Asia, the Middle East, South America, and the West Coast and Southeastern tip of the United States, and that progress continues.
- Not all of these regions is created equal and not only because our largest shareholder happens to be Chinese. Due to its size, wealth, influence, and future prospects, China, in particular, has been an area of our significant focus in the past three years. That is why we are so proud that our East Asia operation led all international auction houses in 2017 with its Hong Kong sales.

- Another strategy we had in early 2015 was to grow our market share of worldwide private sales and the results we mentioned earlier show good progress with more to come in 2018.
- Three years ago we had a strategy to boost our sales within the middle market, which is defined as lots sold at prices between $25,000 and $1,000,000. The middle market includes our crucially important Day Sale material or our very profitable smaller art and object sales held in New York, London, Paris, and Hong Kong.
    - Helped by our strong online sales, superb management within the departments, and an improving art market, our Day Sale activity rebounded strongly in 2017, especially in Contemporary art. More will come in 2018.
- In 2015, we had a strategy to grow our Jewelry and Watches businesses, particularly through continued good work on our auctions, supplemented by more attention to our various private selling activities.
    - Our jewelry position in 2017 was so strong that we found ourselves in the peculiar position where we and one other issued dueling press releases claiming to be number one.
    - We also welcomed a new Managing Director of Global Watches and Jewelry who joined us February 5th based in New York, as well as a new head of Watches based in Hong Kong.
- Our wine business is another area of opportunity. Extremely well managed globally in the auction space, our wine auction sales are off to a strong start in 2018.
    - In late January, we held a sale in Hong Kong that totaled $6.1 million with a 98% sell through rate, and set a new auction record for a single bottle of Japanese Whisky.
    - At the end of this month in Hong Kong, we will represent an anonymous Asian collector in what could be our largest ever single owner wine sale in Asia – 800 lots of wine valued at approximately $7.7 million.

    - Spurred by our new wine retail website on our own platform, we expect strong growth in retail sales in 2018.

- Our Sotheby's Financial Services (SFS) business has exciting strategic expansion opportunities.
    - SFS has grown to a large and robust independently financed business through the end of 2017.
    - Turning to the future, SFS will evolve to extend its benefits to our consignors, our irrevocable bidders, and other clients in our existing ecosystem by enhancing our access, affordability, and speed.
    - Look for plenty of service innovation and growth in 2018 and beyond.
- Following our acquisition of *Art Agency, Partners* in early 2016, the global platform of Sotheby's has provided a powerful foundation for our advisory business. We have many clients that are new to us, and at the same time provided opportunities for us to deepen relationships with existing clients who are well managed by our team of specialists and client relationship managers.
    - We have seen increased activity by many of our advisory clients in our auction rooms globally – both on the consignment and buyer side – and early last year we launched an entirely new branch of services for artists and artist estates.
    - This new artist advisory business has grown more rapidly than we anticipated – now with 13 clients and a number in contract. We have also begun working with a number of clients who are building private museums, presenting us with yet another avenue for growth.

2. Nearly all of our strategies employ the application of technology and much more rapid innovation. For example:

- We have working mobile applications across all operating systems and mobile bidding will be rolled out beginning in this year;
- Last year we held 36 online-only sales, more than double the previous year;
- Our social media program leads the market and is growing in terms of reach and engagement each week;
- Video has become a cornerstone of our marketing program;
- Before it was fashionable, we acquired Mei Moses and turned our focus to collecting and using data analytics to address our clients' needs. Our lead has accelerated with the recent acquisition of the artificial intelligence company Thread Genius;

- We bought a scientific testing company that reviewed over hundreds of objects last year and saved the company millions in potential losses through identification of problematic works of art;
- Our progress on the middle market will be further strengthened with the new low-touch and scalable web-based company called Viyet that we acquired a few weeks ago;
- And the results of this multiyear effort are already benefiting 2018:
    - As of mid-February, 35% of our lots were sold to online buyers (up from 23% for the full year 2017);
    - The number of online bidders this year has jumped 107% versus the same period last year, and the volume of underbidding online, which exceeded half a billion (with a "b") dollars last year, is trending 114% higher thus far this year.
    - And we are not only selling things online, now we are bringing in consignments online and this is a powerful emerging tool for future growth.
- What to look forward to in 2018? More rollouts on Sotheby's new tech platform together with more innovation for clients in affordability, speed, access, and usability.

3. Our capital has been allocated very effectively since 2015.

    - Three years ago our balance sheet carried over $200 million worth of inventory that has been significantly reduced to $74 million today, with another $33 million in reductions expected in the first half of 2018;
    - We have refinanced our debt, raising an extra $100 million to invest in our business;
    - We have bolted on some acquisitions to add capabilities and services to our repertoire so that we may compete more effectively;
    - We have announced enhancements to the gallery spaces in New York, London, and Paris; we expect to invest approximately $60 million on this program to create new state-of-the art galleries, as well as new public and private exhibition spaces.
    - We have repurchased 26% of our shares since mid-2015 and sharply increased our return on equity for investors;
- The good news is that despite all of our previous and planned short term investments, we once again have capital substantially in excess of that needed for our existing business operations. While we will certainly keep our eyes open for the right acquisition, our bias continues to be to repurchase shares.

4. Sotheby's has three assets – superior team, great brand, and plentiful capital – but the most important one by far is our superior team.

- A lot of work has been done over the past few years to build and strategically align the team that we have now and I believe that we have the best team in the industry.

- Let me close by saying that investors should be very pleased to hear that our pipelines are filling up, the prospects for the spring are bright, and the team is very optimistic about 2018.
- I will now turn it over to my colleague Mike to go through our financials.

SPEAKER: Mike Goss, Chief Financial Officer

- Thank you, Tad.
- Before turning over the mic to all of you for your questions, I'd like to address four broad topics:
    1. The financial highlights of the fourth quarter and full year,
    2. The impact of tax reform on our financials, and in particular, how tax reform will impact our tax rate going forward,
    3. How we are managing our balance sheet and the allocation of capital, and
    4. Given all of the above, our thoughts for the year ahead.

1. Financial Highlights

- Starting with our first topic – the financial highlights for the fourth quarter and full year – we exited the year with a stronger market environment than we experienced at any time in 2016, or even the first half of 2017, and this strength translated into higher net sales and revenue for Sotheby's.
    - Our Net Auction Sales grew by 13% in the fourth quarter of 2017 versus the same period in 2016. However, given how this year's Hong Kong sales straddled the third and fourth quarters, it may be more meaningful to look at the trailing six month period where you will see 20% year-over-year growth in Net Auction Sales.
    - Our Private Sales showed similar strength as we exited 2017 – they were up 61% in the fourth quarter and up 23% for the second half.
- In terms of profitability, the themes we've communicated on prior calls throughout the year continued to hold true, namely:
    - Our Auction Commission Margin for 2017 stabilized versus 2016 at 17.2%. This is something we've been anticipating due to both between better deal making and a greater mix of higher priced items where Auction Commission Margins are lower in percentage terms.

  - Secondly, our Adjusted Expenses* were higher than last year by 14% driven primarily by two factors: 1) higher incentive compensation after significant reductions in incentive compensation were made in 2016 (this increase also includes private sales incentives driven by our higher private sales levels) and 2) greater investments in our digital efforts that will drive our growth and lower our costs in the future. With the progress in our digital business that Tad spoke to earlier, we're more confident than ever that the investments we're making in marketing and technology will pay healthy dividends in the future both through higher growth and lower costs.
  - Finally, due to a one-time $0.13 per share tax benefit in the third quarter, a modest deleveraging of our balance sheet as I will discuss further in a few minutes, and a lower number of shares outstanding due to our ongoing share repurchase program, we reported Adjusted EPS* for the year of $2.25, a 32% improvement on a 5% improvement in our Adjusted Operating Income*.

2. Tax Reform

- As with all other US based companies, our financial statements include the provisional impact of the recently enacted tax reform legislation. However, the net impact is very small in our case. The footnotes in our 10K will give you all kinds of detail, but here's how we end up to a very small net impact:
  - First, we have a $20 million non-cash charge to write down the value of our Deferred Tax Assets following the reduction of our US corporate income tax rate from 35% to 21% and the potential limitation of future business deductions.
  - Second, we have a $59 million non-cash benefit to reverse previous tax liabilities recorded on foreign income that we intended to bring back to the US at some point, and
  - Third, we recorded a $40 million liability for the one-time transition tax required for unremitted and untaxed earnings of our foreign subsidiaries. This tax will be paid in cash over the next eight years.
  - Finally I should add, knowing that tax reform and a potentially lower tax rate was on the horizon, we had carefully managed the timing of any repatriation of foreign cash in recent years, which ultimately resulted in substantial savings on our tax bill.
- The net result of these three items is a provisional $1.2 million charge, included on the face of our income statement within our general "Income Tax Expense" line, and excluded from the calculation of Adjusted EPS*.
- The much more interesting part of tax reform for Sotheby's pertains to our plans for the previously unrepatriated cash we were holding abroad and our ongoing effective tax rate against our future earnings.

- First, with respect to the repatriation of cash, we will be bringing in the range of $325 million of cash back from our overseas operations at a significantly lower tax rate than we had previously planned. When I discuss our thinking on Capital Allocation in a few moments, you will hear how we are planning to use these funds.
- Second, with respect to our ongoing tax rate, we expect to benefit from the widely publicized reduction in rate from 35% to 21%, but the impact will be muted by the fact that we're a global company with significant earnings outside of the US. Net net, we are encouraging investors to think of our effective tax rate for 2018 in the 27% range before giving effect to positive or negative discrete items that come up periodically. Of course, this rate is still dependent on the mix of our earnings among our global businesses, and we are all still waiting on further guidance to be issued by the IRS and state taxing authorities.

3. Capital Allocation

- As Tad mentioned earlier, implementing a more efficient capital allocation philosophy has been, and continues to be, a key priority for the Company. To that end, we have made great strides in liquidating excess inventory, being more prudent in writing unhedged guarantees, more tightly managing mismatched terms between consignors and buyers, and freeing up excess cash balances for either debt reduction or share buybacks.
- We also took advantage of a strong bond market in December when we opportunistically refinanced $300 million of senior notes due in 2022 bearing interest at 5.25% with $400 million in new notes due in 2025 bearing a rate of 4.875%. Given the rise in rates since that date and projections for further increases in the near future, that decision is looking good.
- In 2017, we modified our strategy with respect to the use of short-term balances of idle cash. In the years since raising a separate revolving credit facility to finance our loan business at Sotheby's Financial Services, we have always kept large cash balances generated by our Agency business while simultaneously carrying outstanding debt on the revolving credit facility we use to finance our loan business. We did this in order to demonstrate a high return on equity at SFS even though we incurred a negative spread between the interest income we earned on our cash and the interest we paid on our outstanding debt. In our view, it made no real economic sense to Sotheby's shareholders for us to continue this practice.
- Starting in September, we began applying our excess cash balances to our SFS debt, thus eliminating the negative spread on that amount of cash. Once we have a more meaningful long-term use for that capital – say, for stock buybacks, an acquisition, or a capital project – we can always re-borrow the money on our credit line at that time. In fact, we currently only have $65 million outstanding on our line of credit even though we have a borrowing base that supports $450 million in borrowing.

- So where do we stand at present in terms of excess capital? By our estimation, after our typical allocations for business getting needs, downside protection and approved investments, we currently have as much as $325 million in excess capital available to us, largely in the form of undrawn credit against the SFS loan book. This amount includes the $96 million still remaining on our previously announced share repurchase authorization. Yesterday, our Board of Directors approved another $100 million increase to our share repurchase authorization, resulting in an updated share repurchase authorization of $196 million as of today.

4. Outlook for 2018

- We had a good year from both a strategic and financial point of view in 2017. Our market stabilized and then strengthened as the year proceeded. We made great strides against our key growth strategies, and we exited the year with a strong balance sheet flush with available capital. We are pleased that 2017 played out on the bottom line as we expected.
- In 2018, we expect little change to this upward sloping trajectory. We intend to stay the course and continue what we're doing both strategically and financially. That means continued attention to our base auction business as well as to private sales, continued vigilance on our deal making and guarantee writing, continued investing in our digital future from both an operating expense and capital expenditure point of view, and continued focus on generating excess cash for use in or opportunistically buying back stock based on market conditions and / or deleveraging our balance sheet.
- Given the traditional limited visibility in the art market and the recent increase in volatility in global financial markets, we are going to wait and see before confidently predicting a repeat of the last six months' growth rate, but we do feel good heading into the year as far as the pipeline is concerned.
- From an earnings point of view, the themes outlined at the top of my comments remain relevant, which is to say we expect a stronger art market that will aid our top line, and we will keep investing in our technology and marketing programs to drive our future growth higher and cost structure lower.
- The net result is that we think current consensus expectations should remain where they are until we see how things go in the next quarter; with the possible exception of an upward adjustment justified by the impact of tax reform on our effective tax rate.

* Non GAAP financial measure. See the Appendix to the fourth quarter 2017 earnings release as well as our most recently filed 10-K for the period ended December 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.