Sotheby's Second Quarter 2017 Earnings Call Outline
August 3, 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 June 30, 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 us this morning.
- Today, we are reporting second quarter diluted earnings per share of $1.43 compared to $1.52 in the prior period, a 6% decline. For the half, diluted EPS is $1.21 compared to $1.03 per share in the prior period – a 17% improvement. After excluding certain charges in both periods, Adjusted Diluted EPS* improved 8% from $1.13 to $1.22.
- This morning, Mike and I will change things up a bit: I will begin by addressing two questions:
    1. How did we do in the quarter and the first half of 2017?
    2. What are our key takeaways from the second quarter and first month of the third quarter?
- Then Mike will provide detail on the numbers for the second quarter and first half results, after which I will come on again and say where Sotheby's is headed.

- So how did we do in the quarter and the first half of 2017?
    - Overall, the quarter was solid. Revenue was up by 5% during the quarter mainly due to a rise in inventory sales but also a noticeable and welcome improvement in the performance of our guarantees in the auction room versus a year ago.
    - We are pleased that these results were slightly better than we anticipated on the last earnings call when we cautioned that we were up against tough comparisons on revenue because of an outstanding spring sale series in Asia and the record jewelry sales in Geneva last year.

- When reviewing our quarterly expenses, please note that we have provided for staff bonuses at their target levels versus last year's much reduced level. In addition, equity compensation expense has increased due to the improved performance against our return on invested capital targets, which is a good thing for investors.
- The quarter also reflected the effects of investments we have been making in technology, specialist expertise, and digital marketing to take our company's secular growth trajectory to the next level. Later in the call I will say more about those investments and what investors can expect in the future.
- So overall the quarter was solid and I am confident more growth will come both as the market improves and as our investments begin to yield returns.
- Our results reported today also shine a light upon many encouraging aspects of our business:
    - One has been private sales, which for the first half of 2017 are up 34% over the prior year to $333.8 million.
        - We also had substantially more private sales transactions in the first half of 2017 than we had in any of the similar periods of the prior four years; for example, the number of sales was up 52% from the first half of 2016.
    - Versus one year ago, the number of overall transacting clients for the quarter is up 10%. The result was an increase of 19% in the average number of bidders per lot sold and a rebound in average hammer versus the low estimate from 97% to 112%.
        - Speaking of clients, the number of new clients grew in the first half of the year versus a year ago by 4%, and their average hammer purchased soared by 59%.
    - Another big change in the first half was the return of high-priced lots. For example, lot unit growth above $1 million was up 5% and total average hammer for those same lots was up 17%. The number of buyers in that same $1 million+ lot band rose 10% and sellers rose 13%.
    - Overall geographic dispersion of the buying volume reflected a sharp rebound in American buying – up 26% versus a year ago first half – to displace Asia as the largest purchasing region by dollar volume. Continental Europe also grew 18%. We were also pleased that Asia buying, already very large, nonetheless grew 3% in the quarter.

- Our online progress continues to be a good story. To be clear in our terminology, we have two types of online sales. The first is the online participation in live sales that are conducted in our auction rooms around the world. The second is what we call "online only" sales which occur entirely online. Unless we say "online only," all of the statistics below incorporate both.
    - For the first half of the year, 22% of our lots were sold to online buyers, versus 19% a year ago and 13% two years ago.
    - More registrants and bidders are participating online than ever before, and the total value of online underbids rose 23% from the first half period in 2016.
    - The buying behavior online is truly global: in our New York sales, 26% of all lots sold to online buyers, and our salesrooms in London, Hong Kong, Geneva and Paris all saw percentages in the double digits as well.
    - The behavior is also across categories, with our top five lots sold to online bidders coming from our Contemporary, Jewelry, Latin American, Prints and Fine Chinese Paintings departments.
- Turning now to our "online only" sales, which were launched last year, we are exceeding our expectations:
    - The number of online only sales last year was 16 and we are on track to double that in 2017.
    - Our overall sell-through rate in online only sales improved to 81% compared to 62% in 2016.
    - Most importantly, online only sales continue to be among our best methods of acquiring new clients – 45% of buyers in those sales were new to Sotheby's.
- Our digital editorial products have done well in the first half. For example:
    - The growth in paddle registrations by the audience reading our editorial content outpaced overall growth in registrations by 77%.
    - The percentage of site visits by editorial readers that include a paddle registration is 37% higher than the overall average.
    - Over the coming year, we will begin to measure the actual return on investment of each piece of editorial we create and therefore will have a much clearer picture on this effect.

- Turning to the second question: What are our key takeaways from the second quarter and first month of the third quarter?
    - Broadly speaking there is not much change in the market from what we said on the last earnings call, but I will summarize briefly the state of the art market. The things we sell fall largely into two groups:
        - The first group is masterpieces that are fresh to the market and are in excellent condition. Demand for works in this first group is robust and pieces sell at very high – some would say "eye-popping" prices. However, that is only a small part of the market story.
        - If a piece we sell is not fresh, not the best example of an artist's oeuvre, or not the most desirable artist, then demand for the piece is quite discerning and the price will need to be realistic in order for it to sell. In other words, the market for fine objects is healthy and efficient but neither frothy nor depressed.
        - One consequence is that we are working hard to get prospective consignors either to part with their masterpieces we described in group one or to realize that their favorite work of art is really in group two and they need to be realistic about price expectations for it to sell.
    - However, it was encouraging to see that, according to Sotheby's Mei Moses database, the average and median returns on art sold in the first half of 2017 stabilized versus the full year of 2016 based upon a sharp rise in the average and median returns on sales of Contemporary Art.
    - As for exogenous market factors, I have spoken about them extensively on prior earnings calls and there is not much to add to my prior comments except perhaps to acknowledge that the uncertainty in Washington D.C. is troubling.
- I will now turn it over to Mike for a review of the results before coming back to me to discuss where Sotheby’s is headed in the future.

SPEAKER: Mike Goss, Chief Financial Officer

- Thank you, Tad
- As Tad alluded to earlier, during the course of our last earnings call, we indicated that we expected “*little, if any, EPS growth during the first half of the year*” and that “*revenues generated by our strong North American spring sales may well be offset by tough comparisons elsewhere*” – and we identified our 2016 Hong Kong spring sales, our

record breaking Jewelry sale in Geneva last May, one time fees at SFS from last year, and adverse exchange rates versus last year as the primary sources for the tough comparisons.

  - We turned out to be right, although we actually came in slightly better than we anticipated three months ago with our first six month Adjusted Diluted EPS* coming in at $1.22 versus $1.13 during the same period a year ago.
  - This morning I plan to cover the results of the most recently completed quarter in our typical detail. But as we've suggested many times before, we also want to spend time on the six month results because we think such analysis helps to overcome some of the seasonal peculiarities of our business and provides more insight into the current state of our business.

- Let's start with our sales activity:
  - First, let's discuss the Aggregate Auction Sales that are reported on our investor relations website. When the hammer comes down in the auction room, a sale is generated and the hammer price is recorded along with the Buyer's Premium (BP). If the transaction takes place abroad, the hammer price and BP are translated into dollars using that day's exchange rate. For the first half of 2017, such Aggregate Auction Sales using this methodology were up 8%, and the second quarter sales were up 5%. (The decline of the British pound was significant since last year, and for those who have interest, our first half and quarterly growth in sterling – rather than US dollars – grew 22% and 18%, respectively.)
  - Second, is our Aggregate Auction Sales that are reported in our 10-Q filed with the SEC. This starts with those sales reported on our website but, importantly, it excludes any property that we sell in the auction room from our own inventory or sales that don't yet qualify for sale recognition under Generally Accepted Accounting Principles as an Auction Sale. For the first half of 2017, Aggregate Auction Sales as reported in our 10Q were down 2% and for the second quarter were down 1%. On a constant currency basis, I should note, they rose slightly for the quarter (up 2%) and the June year-to-date period (up 3%).
  - Third is Consolidated Sales, which are an important metric that provides visibility into the broadest level of activity across Sotheby's. This measure includes our auction sales, our sales from our own inventory, and the private sales we do. For the first half of 2017, Consolidated Sales were up 4% and for the second quarter up 2%. On a constant currency basis, Consolidated Sales were up 9% and 5% for the six and three month periods respectively. Consolidated Sales is the most representative of how we currently view the

strength of the markets in which we compete and our own performance. (The first half and quarterly growth of Consolidated Sales in British pounds – rather than US dollars – were 18% and 14%, respectively.)

- With respect to our Auction revenue:
    - Our Auction Commission Margin was largely flat for the quarter at 16.3% this year versus 16.4% last year. However, we are very pleased with this result given the substantially larger number of lower margin, higher priced fine art pieces sold in the major evening sales in New York and London associated with the recovery this year. For the six-month period, our Auction Commission Margin of 16.7% was better than last year's level of 16.1%, and we still expect to end the year with a modest improvement in margins year-over-year despite the greater mix of lower margin, higher priced objects.
    - Two other items of note on revenue in the second quarter. First, our book of guarantees and irrevocable bids performed very well as evidenced by the strong growth in Other Agency Commissions and Fees (up $7.7 million), and secondly, we reported lower Facility and Other Fees generated at SFS (down $3.5 million) due to the inclusion of unusually large collateral release fees in last year's quarter.

- Moving on to Adjusted Expenses*:
    - We were once again higher than we were for the year ago periods: up 11% for the quarter and up 9% for the six-month period. Looking forward, we reiterate our view that we expect Adjusted Expenses* to end the year closer to our spending level of 2015. This increase is primarily the result of a restoration of our annual incentive compensation to targeted levels in 2017 and higher spending against our various growth initiatives that is intended to drive our future growth.
    - On a related note, it's worth pointing out that we frequently have the opportunity to invest in startups in the digital space and while we are always on the lookout for innovation and specialized technologies, we frequently, though not always, conclude that it is much more economic to "make" our e-commerce capabilities ourselves than to "buy" them from others. However, the consequence of this decision, while economically rational, has the effect of elevating our operating expenses while such capabilities are being developed. But we make these investments in full expectation that they will yield economic benefits in the not too distant future.

    - Before moving to the balance sheet, it's interesting to point out that foreign exchange rates cost us $6.9 million in operating profit in this most recently concluded six month period, largely because of the importance of our UK business in the first half of every year. To put that figure into perspective, this is a $0.09 per share negative impact on our first half EPS.

- On the balance sheet, we have several items to flag for investors:
    - First, we are very pleased with the performance of our Sotheby's Financial Services business. Our average loan portfolio balance rose 5% versus the year ago quarter, and if one excludes a one-time unusual collateral release fee from a year ago, our underlying profits rose sharply.
    - Second, our capital allocation measures to convert our inventory to cash continue, with our quarter-end inventory balance now standing at $131 million on a reported basis. But quite importantly, that balance still includes the entire amount of the $68 million Pink Diamond, which was sold at auction during this quarter but will not be recognized as a sale under GAAP until we collect the money from the buyer, which we anticipate to happen within the year. Recall that at the end of 2015, we held $215 million in inventory, so our progress has been meaningful, down by 71% since 2015 once the Pink Diamond is accounted for. Moreover, our earnings over the past two years have been negatively impacted by write downs on inventory that had accumulated over many years. In the first half of this year alone, such writedowns totaled $8 million, or $0.10 in earnings per share. But that inventory is now being converted to cash and put to better use for investors.
    - Secondly, as we reported in an 8K filing in June, we amended our York Avenue mortgage and prepaid the principal balance by $32 million in return for a reduction in our minimum net worth covenant in order to continue to provide flexibility for share repurchases. Other than a very small amount ($6 million), we have no current authorization remaining on our stock buyback program. However, as we continue to evaluate the best uses for any excess cash, we can and will move quickly if we conclude that increasing the authorization is best for Sotheby's and its shareholders.
    - As we look ahead to the third quarter, we are mindful that in 2016 we generated only 4.5% of our total Net Auction Sales for the year in the third quarter. As a result, third quarter results usually tell us very little. I anticipate that on our next call together we will once again be encouraging investors to look at our six month run rate as a more meaningful measure of our financial health.

    - We will share more about the fourth quarter on the next earnings call, but for the near term we are managing our business in a manner that anticipates a continuation of our modestly upward sloping trajectory on Consolidated Sales. For the longer term, we plan to continue to focus on our strategic growth initiatives and on efforts to efficiently fund such growth and allocate our capital.

- With that, I am going to hand things back to Tad.

<u>SPEAKER: Tad Smith, President and Chief Executive Officer</u>

- Thank you, Mike.
- So, where is Sotheby's headed?
    - Our vision is "To be the world's preeminent destination to discover, experience and trade valued objects."
    - In pursuit of that vision, we have four key priorities: strategy, technology and innovation, team, and capital allocation.
    - So what can clients, investors, and staff expect in the next couple of years?
    - Here are some key themes on my mind:
        - In terms of strategy, we will continue to fill out our suite of services to buyers and sellers who appreciate our ever-greater sophistication and creativity.
        - Art advisory will continue to expand with more clients, services, and deeper relationships. We have already seen a more than 20% increase in the number of clients since we acquired the firm. As for our new business of advising artists and artist estates, we are pleased to have signed up 10 new clients and with plenty more in the pipeline.
        - Jewelry will be a meaningfully larger part of our business and our services will migrate from mainly auction to greater private sales, both in-person and through online marketing and e-commerce.
        - Already the strongest worldwide player in auctions, wine will also be a meaningfully larger part of our business and our services will migrate to greater collection services, curation, and online sales.
        - Our marketing materials will be digital and social, and our selling strategies both digital and personal.

    - A mainstay of our history and the market, the traditional print catalogue, will remain only for those who value it, want it, and use it.
    - At the same time, our digital catalogues will be greatly enhanced with each passing quarter.
- Our staff will have great digital tools that reduce the time and resources they devote to manual processes that yield no value for clients or shareholders. Our auction room, for example, will be paperless.
- Our clients will experience much more consistent levels of service as well as a more tailored and personal service delivery model.
    - Those who prefer a friendly phone call and regular visit will receive it. Those who want a terrific digital experience with personalized recommendations engines will have that.
    - But even the friendly phone call or visit will be made more consistent in its service quality by the enablement of digital tools.
- In terms of our staffing I have several thoughts to share.
    - First, we have been adding staff who are skilled specialists, experts in needed technologies, strong salespeople, and excellent digital marketers.
    - At the same time, we have an opportunity now to pause and re-examine our cost structure in areas that are not growing or where automation, data, or standardization of processes will yield significant savings. We believe that there are numerous opportunities for our company to improve efficiency and productivity, and we will address this opportunity by the end of this year.
- I arrived at Sotheby's in March 2015 to find a talented and dedicated group of people.
    - What we set out to do was to build "one team" from the talented individuals to serve clients and shareholders at a high performance level around the world.
    - Now, over two years later, we have made progress toward that "one team" objective, but my colleagues and I have identified areas where we still fall short (and, by the way, our clients and shareholders sometimes suffer as a result).

    - The good news is that we are relentlessly focused on the “one team” culture –and this will bring noticeable benefits over the next couple of years.
  - In summary, we continue to refashion Sotheby's right now for an even more successful future than its illustrious 273-year past. We are confident that our success will be shared among clients, shareholders, and our winning team.
- Mike and I are now happy to address your questions.

* Non GAAP financial measure. See the Company’s Form 10-Q for the period ended June 30, 2017 for an explanation of the non-GAAP financial measures used in this earnings call, as well as reconciliations to the comparable GAAP amounts.