

Sotheby's Third Quarter and First Nine Months 2008 Earnings Call Outline

November 7, 2008

Summary:

- Today we are announcing third quarter revenues of \$76.0 million which is a \$9.1 million, or 11%, decrease from the prior period. From a sales and auction commission standpoint, the third quarter was very good for Sotheby's. The decline in revenues is largely due to a higher level of principal activities losses recorded in the third quarter relating to fourth quarter guarantees. This decline is partially offset by the shift of our summer Contemporary sales in London from the second quarter of 2007 to the third quarter of 2008 as well as the landmark sale of Damien Hirst's works in London in September.
- Included in third quarter revenues is an increase in principal activities losses over the period. These losses comprise: \$15 million relating to guarantees in the October Hong Kong and London Contemporary sales, \$10 million relating to guarantees in the November New York Impressionist sales and \$17 million relating to probable losses for the guarantees in the New York Contemporary sale next week. As these obligations were outstanding as of September 30, they are included in our third quarter results.
- We have minimal guarantee exposure remaining. After the Impressionist sales earlier this week, our net guarantee exposure is now \$114 million which largely relates to our Contemporary sales next week - sales which we have assessed prudently and as I said, for which we have already recorded \$17 million in anticipated losses. And after our Contemporary sales, we will have net guarantee exposure of \$13 million remaining. We have reduced our guarantee position by over 50% as compared to last year and expect to continue to significantly reduce our use of auction guarantees and other special concessions to consignors until such times as stability is restored in the global economic environment and in the financial markets.
- As our Impressionist results earlier this week demonstrated, there *is* demand in the marketplace for great works of art. We sold three paintings for over \$30 million, with each one setting a record for the artist, and Malevich's *Suprematist Composition* achieved \$60 million, the top lot of the autumn season. While sales totals came in below our pre-sale expectations it is important to note that these sales were largely assembled over the summer when the world was a different place. In light of global economic realities, our ability to sell \$223 million in the evening sale is particularly meaningful in this environment, given that it is comparable to the same sale just this past May.
- But as a result of the challenging global macroeconomic conditions, we are announcing today that we will be implementing a global cost cutting initiative that we expect will lead to material cost savings across our organization. Subject to approval of our plans by our Board, we expect to take restructuring charges in the fourth quarter of this year as well as the first quarter of 2009. It is all too clear that we cannot at this moment peg where our sales levels will be next year - no one can - but we *can* manage our costs in ways which will ensure our financial health, even at top-line sales levels far lower than where they are today.
- While this is indeed a relatively high fixed cost business, through reducing our guarantee activities, resizing our organization and requiring from sellers that we receive returns which reflect our services, we expect that we will be able to reset both the margins and the profitability as a percentage of sales.

Overall Results

- Net loss for the **third quarter** of 2008 was (\$46.2) million or (\$0.71) per share, compared to a net loss of (\$20.9) million or (\$0.33) per diluted share, in the prior period.
 - This deterioration is largely due to a higher level of principal activities losses and lower private sale commissions, and to a lesser extent, higher borrowing costs, and a lower effective income tax rate which results in a lower tax benefit for the quarter. Results for the quarter benefit from the shift of our London Contemporary sales from the second quarter of 2007 to the third quarter of 2008 as well as the landmark sale of new works by Damien Hirst in London in September.
- Net income for the **first nine months** of 2008 was \$36.7 million, or \$0.56 per diluted share, compared to \$110.7 million, or \$1.69 per diluted share for the prior year period.
 - This decline is largely due to lower auction and related revenues resulting from a more unfavorable guarantee experience, lower private sale commissions and a lower auction commission margin.
 - Also contributing to the lower year-to-date results are higher sale promotion costs and general and administrative expenses. Partially offsetting the impact of these factors is lower year-to-date salaries and related costs.
 - Impacting **first nine months** results is the \$11.7 million after-tax benefit from the reversal of the remaining coupon liability in conjunction with the settlement of our antitrust related civil litigation.

Operating Revenues

- In the **third quarter** of 2008, operating revenues totaled \$76.0 million, a \$9.1 million, or 11%, decrease from the prior period.
 - This decline in **third quarter** revenues is largely due to increased principal activities losses related to auction guarantees from the October Hong Kong and London Contemporary sales (\$15 million loss), the November New York Impressionist sales (\$10 million loss) and estimated principal activities losses relating to our Contemporary guarantees in the New York sales next week (\$17 million loss) - as those losses are deemed probable and were obligations that were outstanding as of September 30, 2008.
 - Also negatively impacting **third quarter** revenues are lower private sale commissions and a lower auction commission margin which is largely due to the change in sales mix in the quarter with the shift of the summer London Contemporary sales from the second quarter of 2007 to the third quarter of 2008 as those sales are at the high-end of the business and therefore carry lower auction commission margins.
 - In the third quarter, auction commission margin was 15.2% which is slightly higher than the second quarter of 2008 and which is notable, given the distinct difference in sales mix in the

two quarters. Traditionally, sales from high-end works - such as Contemporary - bring lower auction commission margins. In the second quarter of 2008, Contemporary Art accounted for approx. 26% of sales while in the third quarter, Contemporary Art was fully 56% of our sales.

- Also, **third quarter** auction commission margin improved 12%, from 13.6% to 15.2%, when compared to the first quarter of 2008. This improvement is directly attributable to our efforts to manage terms given to consignors as well as the buyer's premium increase which went into effect this past June 1st.
 - Revenues in the quarter benefited from the shift of our summer London Contemporary sales from second quarter 2007 to third quarter 2008 which brought auction commission revenues of \$24 million in the **third quarter** of 2008.
 - Also positively effecting **third quarter** results is the landmark sale of Damien Hirst's works in London in September which brought net sales of \$176 million for our first sale of its kind, dedicated to the works of a single living artist.
- For the **first nine months** of 2008, operating revenues totaled \$525.4 million, a \$46.6 million, or 8%, decrease from the prior period, primarily due to the aforementioned increases in principal activities losses, lower private sale commissions and lower commission margins.
 - Lower commission margins were partly the result of sales mix as mentioned previously, but also impacting margins was an increase in risk reduction arrangements employed to lower our auction guarantee risk in response to an uncertain economic environment, as well as increased competition for consignments.

Direct Costs of Services

- Consists largely of catalogue production and distribution costs, as well as sale marketing costs and shipping expenses.
- For the **three months** ended September 30, 2008, direct costs of services increased \$5.6 million, or 65%, to \$14.3 million when compared to the prior year. This increase is primarily attributable to:
 - Approximately \$3.6 million of costs related to promotion of the unprecedented Damien Hirst *Beautiful Inside My Head Forever* sale.
 - The change in the timing of the early summer Contemporary Art sales in London from the second quarter of 2007 to the third quarter of 2008. In 2008, these sales were held in early July and as such the related \$2.2 million of promotional costs are reflected in the third quarter of 2008.
 - A higher level of property loss and damage claims (increase of \$337k in the quarter).
 - These increases were partly offset by the costs to promote and execute the private sale of the Rostropovich Collection of Russian Art in September 2007, for which there was no comparable sale in the third quarter of 2008.

- For the **nine months** ended September 30, 2008, direct costs of services increased \$15.0 million, or 31%, to \$63.0 million, when compared to the prior **nine month** period largely due to:
 - Costs related to promotion of the (RED) charity auction in February and the Damien Hirst sale in September for which there were no comparable sales last year.
 - Higher consignment levels and increased sale venue rental costs in Hong Kong.
 - Higher catalogue and sale promotion costs related to the spring Impressionist and Contemporary Art Sales in New York.
 - Increased traveling exhibition costs reflecting the Company's efforts to promote its sales globally, including in emerging markets.
 - A higher level of property loss and damage claims (increase of \$1 million in the period).
 - Partly offsetting these increases are savings due to the cessation of auction sales conducted in our former Olympia salesroom, in West London, which held sales of items at substantially lower price points than our other salesrooms.
 - These increases are not a proxy for projecting our selling expenses going forward and we are actively pursuing measures to materially dial back these expenditures in the current environment.

Marketing Expenses

- Marketing expenses are costs related to the promotion of the Sotheby's brand, including the cost of client service initiatives and strategic sponsorships of important cultural institutions.
- Marketing expenses increased \$0.8 million to \$4.0 million in the **third quarter** of 2008 and \$2.6 million to \$14.9 million in the **first nine months** of 2008 as compared to the same periods of 2007 due to an increased level of corporate sponsorships of leading museums and cultural institutions in the United States and the United Kingdom, as well as higher costs to promote the Sotheby's brand around the world.
 - The impact of these increases was partially offset by the costs of several strategic client service initiatives incurred in 2007 that did not recur in the current year. These costs will come down in 2009.

Salaries and Related Costs

- Salaries and related costs decreased \$2.4 million, or 4%, to \$52.9 million in the **third quarter** of 2008 and \$9.2 million, or 5%, to \$185.9 million in the **first nine months** of 2008 as compared to the same periods in 2007.
 - For the **nine months** ended September 30, 2008, salaries and related costs were negatively impacted by \$3.5 million as a result of movements in foreign currency exchange rates.

- These improvements are largely due to lower employee benefit costs over both periods as well as an \$11.7 million, or 39% decrease in incentive bonus costs in the **first nine months** of 2008 which is attributable to the decline in profitability over the period. We will continue to manage the level of incentive bonuses in relation to profitability.

General & Administrative Costs

- For the **three and nine months** ended September 30, 2008, general and administrative expenses increased \$1.4 million, or 3%, and \$9.3 million, or 8%, when compared to the same periods in the prior year, largely due to the following:
 - An increase of \$0.7 million, or 2%, in the **third quarter** of 2008 and an increase of \$3.9 million, or 10%, in the **first nine months** of 2008 in professional fees.
 - The increase in the **first nine months** is primarily attributable to a \$2.7 million increase associated with the Company's outsourced tax compliance function. To a lesser extent, the increase for both periods is also attributable to higher consulting, audit and legal fees. The comparison of professional fees is favorably impacted by \$3.3 million in costs recorded in the **first nine months** of 2007 associated with the Company's assessment of its rights and options with respect to the York Property, for which there are no comparable costs in 2008.
 - An increase of \$1 million, or 15%, in the **third quarter** of 2008 and \$2.7 million, or 13%, in the **first nine months** of 2008 in travel and entertainment costs principally due to a higher level of travel in pursuit of business opportunities and in response to the increasing globalization of the Company's client base as well as higher costs for airfare and hotels.
 - Increases of \$2.1 million and \$4.4 million, respectively, in premises rental and other facilities-related costs, primarily as a result of the need for additional space in London.
 - Unfavorable movements in foreign currency exchange rates, which increased general and administrative expenses \$1.7 million during the **first nine months**.
 - Favorably impacting the comparison of general and administrative expenses to the prior periods are decreases of \$0.9 million and \$2.0 million in client goodwill gestures, authenticity claims and other litigation-related matters for the **three and nine months** ended September 30, 2008, respectively.

Net Interest Expense

- For the **three and nine months** ended September 30, 2008, net interest expense increased \$3.9 million and \$7.2 million, respectively, when compared to the prior year largely due to the incremental interest expense related to the Convertible Notes and Senior Notes issued in June as well as lower average cash and short-term investment balances and lower interest rates earned on those balances.

- In February 1999, the Company issued a 10-year bond for an aggregate offering price of \$100 million. In July 2008, the Company redeemed these debt securities for \$105.7 million. As a result, we recognized a bond early redemption cost of \$2.5 million in the third quarter of 2008.

Income Tax (Benefit) Expense

- For the **third quarter** ended September 30, 2008 and 2007, the Company's effective tax benefit rate was approximately 30.6% and 44.1%, respectively. The lower effective tax benefit rate for the current quarter compared to the prior period is primarily due to the favorable impact of a net income tax benefit of \$2.2 million in the third quarter of 2007 principally relating to the valuation allowance for state deferred tax assets.
- For the **nine months** ended September 30, 2008 and 2007, the Company's effective tax rate was approximately 34.2% and 25.5%, respectively. The increased effective tax rate for the **first nine months** of 2008 is primarily due to a higher level of state and local income tax expense during 2008, as well as tax benefits recorded in 2007 relating to the valuation allowance for state deferred tax assets.

Liquidity Information (in millions)

	9/30/08	9/30/07
Cash	\$235.4	\$121.1
Restricted Cash	\$0.8	\$6.0
Total Cash	\$236.2	\$127.1
Current Assets	\$1,262.3	\$823.3
Current Liabilities	\$595.1	\$474.3
Credit facility borrowings	\$-	\$ -
LT Senior debt	\$348.1	\$99.9

As of yesterday, our cash balance was approximately \$560 million.

Fourth Quarter Sales

- As I mentioned, this week in New York, we held our Impressionist and Modern Art sales, which did not meet our pre-sale estimates. Nevertheless, the evening sale brought \$223 million, closely comparable to the \$235 million achieved in the same sale just this past May, and had three works selling for over \$30 million: Kazimir Malevich's *Suprematist Composition*, for \$60.0 million, a record for a Russian work at auction and for the artist; Edvard Munch's *Vampire*, for \$38.2 million, a record for the artist at auction; and Edgar Degas' *Danseuse au repos*, for \$37.0 million, a record for any work on paper sold at auction and for the artist. All exceptional sales in light of the current global macroeconomic environment and demonstrating that the art market is certainly alive.
- Last month, Asia Week in Hong Kong fell below our pre-sale low estimate of \$224 million but brought the third highest total ever for a sales series at Sotheby's Hong Kong with \$140.7 million.

Upcoming Sales

We have a number of exciting sales before we finish out the fourth quarter. Notable highlights are:

- On November 11th and 12th, we will hold our fall sales of Contemporary Art in New York. The sales have an estimate of \$284 million in total and we have a number of exceptional pieces on offer.
 - The centrepiece of the sales is Yves Klein's *Archisponge RE11*, the most significant work in his *Relief Eponge* series from 1960 and is estimated in the region of \$25 million.
 - Also, there are two exciting works by Roy Lichtenstein, *Half Face with Collar* from 1963 which has an estimate of \$15/20 million and *Interior with Red Wall* from 1991 which has an estimate of \$8/10 million, one of the last major series he painted before his death in 1997.
- In London in the last week of November, sales of Russian art are estimated to bring \$47/68 million. The highlight of the evening sale is Ivan Aivazovsky's *Constantinople and the Bosphorus* (estimated at \$4/5 million) which is one of his most spectacular landscape paintings of when he first visited Constantinople in 1845.

Competitive Environment/Outlook

- By next week, we will have essentially cleared our guarantee portfolio and expect that the vast majority of losses relating to fourth quarter guarantees are included in these third quarter results. Going forward, we will generally not be using our capital for Guarantees until stability is restored in the global economic environment and in the financial markets and where we see unprecedented opportunity.
- Our receivables balance has decreased significantly from June (\$1B) to \$550M at the end of September reflecting significant collections throughout the quarter. The increase from last year's September balance (\$0.3M) is primarily due to the Damien Hirst sale and the higher level of sales in the 3rd quarter of 2008. Our bad debt experience continues to show low levels of write-offs.
- When you look at this business, in this economic environment, I believe it is critical to not look slavishly only at the quarter on quarter performance, but also on the stability and strength of the capital stack within the organization. We can look with confidence at our early maturities on debt being in 2013, and are incredibly fortunate to have a very stable and liquid balance sheet. We drew our revolvers down partially in October as the race toward liquidity was gyrating without a center and causing great consternation. As that stabilizes, we currently expect that we will be returning capital drawn under our revolvers to our lending banks.
- We look toward next year comfortable in the knowledge that our liquidity is strong, our margins are stabilized and improving and we have vastly reduced our guarantee exposure. Going forward, we will significantly reduce our guarantee portfolio as well as other special concessions we grant to sellers in order to attain a fair return for our services and this will remain our focus. While no one can predict where sales levels will go in this environment, especially in the near term, the initiatives we will be implementing should position us to be profitable at significantly lower sales levels and to provide positive returns to shareholders even in an environment of unprecedented economic challenge.

Note: Estimates reflect amounts published in catalogues and have not been adjusted for current market uncertainties. Estimates do not include buyer's premium.

Forward Looking Statements:

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 a non-GAAP basis. When significant, the Company excludes the impact of changes in foreign currency exchange rates when comparing current year results to the prior year. Consequently, such period-to-period comparisons are provided on a constant dollar basis by eliminating the impact of changes in foreign currency exchange rates since the prior year. Management believes that excluding the impact of significant changes in foreign currency exchange rates when comparing current year results to the prior year provides a more meaningful discussion and analysis of fluctuations in the Company's operating results.

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 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.