

SOTHEBY'S WITH ONE STEP CLOSER TO THE GRAVE

*The stock market is filled with individuals who know the price of everything,  
but the value of nothing.*

by Philip Arthur Fisher

It has been a disastrous year for Sotheby's, but the writing has been on the wall for a while. A series of unfortunate events has driven Sotheby's to walk a tightrope, beginning with Bill Ruprecht stepping down in November 2014 -amid criticism- as CEO after being with the company for 34 years. His rookie successor, Tad Smith, and the new amateur directing board committee have exhibited their lack of experience within the art market, refocusing company ideals to make Sotheby's a marketing brand that favors advertising and technology for online retail. The new management, forgetting that art remains a business where knowledge



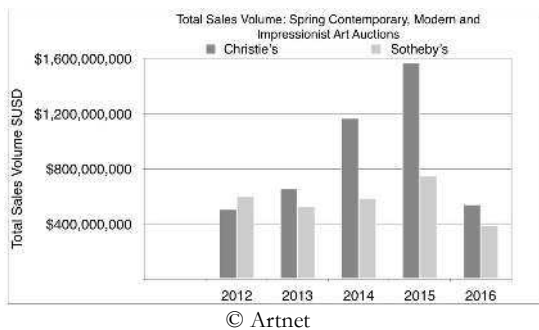
By Larry Brown from Cartoon Stock

really matter, has adopted a new strategy limiting PR expenses. This has led to an unprecedented exodus of the company's best asset: knowledgeable staffers with strong client relationships and more than 300 years of experience. Vicepresidents, Specialists, Worldwide Heads, Chairmen, and even CFOs have abandoned the sinking ship. The resulting feeling of an uncertainty and instability now pervades the glittering glass-and-granite-fronted building on Manhattan's Upper East Side. Personally visiting the venue on Sunday, left us with the distressing feeling of a rundown business, just like a ghost with spiritual emptiness, or a phantasmagoric carcass of what once was one of the world's largest brokers of fine art.

In a desperate effort to compensate for the auction house's emptiness, the board of directors decided to overpay the private firm, Art Agency Partners, around \$85 million on January 11<sup>th</sup>, 2016 to boost private sales. Thus, this auction season, all art market analysts' eyes were on Sotheby's expecting a miracle with Amy Cappellazzo as Sotheby's triumphant savior. As expected, Post-War and Contemporary auctions developed smoothly with an astonishing 95% sell-through rate. It was a solid



\$242 million sale made extraordinary if we consider the context within which it was developed but a small sale nonetheless. Clearly the resulting revenue from this sector is not enough to cover the entire auction house's expenses and debts. The failing 66% BI-rate for the Modern and Impressionist catalogue was a big downturn for Sotheby's confidence. Excluding Post-War and Contemporary, the lack of talent on the other business sectors has deeply affected the quality and quantity of artistic offer. To summarize, Sotheby's total sales volume dropped almost by half: last year the house generated \$748 million in sales, compared to this year's \$386 million.<sup>1</sup> Furthermore, it seems that Sotheby's own team



tries to boycott its own selling process. The Latin American auction held on May 24<sup>th</sup>, suffered from serious technical problems for the morning online bidding, when the firm was unable to stream the live auction or place the selling results. The Latin American department surely worked very hard for six months, only to find themselves victims of the IT department's inefficiencies.

As a result, the insufficient cashflow forces the company heavily depends on its credit facility. In fact, Sotheby's has just announced that total sales revenue dropped 8%, suffering a \$73M loss in 2015, which incremented \$11M from last year's forfeiture of \$66M. In 2015, Sotheby's gross margins narrowed from 47.25% to 43.72% compared to the same period last year, operating (EBITDA) margins now 27.19% from 30.75%.<sup>2</sup> Narrowing of operating margins contributed to decline in earnings. As of today, Sotheby's EBITDA<sup>3</sup> margin keep falling, since on Friday 10<sup>th</sup>, the company's EBITDA was of 14.58.<sup>4</sup> This position had seriously affected Sotheby's BID stock, which has crashed 54% over the past twelve months. Consequently, Sotheby's current credit rating is at risk. That is to say, if Sotheby's corporate credit rating from Standard & Poor Rating Services is downgraded to "BB-", "B" or "B+"<sup>5</sup>,

<sup>1</sup> Kinsella, Eileen, and Brian Boucher. "Experts Weigh In on Auction Week." *Artnet News*. 16 May 2016. Web. 24 May 2016. <<https://news.artnet.com/market/experts-weigh-in-on-auction-week-497876>>.

<sup>2</sup> <http://www.capitalcube.com/blog/index.php/sothebys-earnings-analysis-2015-by-the-numbers/>

<sup>3</sup> EBITDA margin is a measurement of a company's operating profitability as a percentage of its total revenue. It is equal to earnings before interest, tax, depreciation and amortization (EBITDA) divided by total revenue.

<sup>4</sup> <http://www.gurufocus.com/term/ev2ebitda/BID/EV%252FEBITDA/Sothebys>

<sup>5</sup> "S&P Global Ratings Definitions." *Standard & Poor's | Americas*. 3 May 2016. Web. 24 May 2016. <[https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352)>.



the revolving credit line might be recalled and the auction house may be facing insolvency problems too frightening to even mention.

In addition to the current long-term debt of \$603 million, Sotheby's 25-year-mortgage originally had an initial annual rate of 5.6% has now increased to 10.6%.<sup>6</sup> In fact, the possibility of relocating the business' headquarters was presented at the New York Times in June of 2013. According to the New York Post, Sotheby's has retained Peter Riguardi of commercial real estate company JLL to help it search for a new location, possibly in the Hudson Yards development on Manhattan's far west side.

In what may be a *coup d'grace*, a private, Singapore-based investment group called Shanda has just announced its ownership stake in Sotheby's. Shanda originated as an online gaming company and is run by co-founders Tianqiao Chen and Chrissy Qian Qian Luo. They currently own two percent of Sotheby's shares and could increase their stake to as much as 10 percent, raising the possibility that Sotheby's could be acquired or taken private.<sup>7</sup> According to Forbes, Chen, a self-made millionaire was a pioneer in China's online game industry a decade ago and holds a Bachelor of Arts from Fudan University. As a collector himself, Tianqiao Chen might be acquiring prestige through the auction house's purchase. In case you have not recalled this situation, the name Alfred Taubman might sound as a *déjà vu*. That is to say, Alfred Taubman took over the auction house in 1983, after he was object of ill treatment at Sotheby's before he bought the business.<sup>8</sup> Would Chen's money be just a tantrum or a fuel of fresh energy that Sotheby's urgently needs? Let us hope that China's 10th richest man truly understands the situation he is getting into.



Alfred Taubman

**By Giovana Edid and Javier Lumbreras**

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<sup>6</sup> Bowley, Graham. Sotheby's Considers Putting Its Headquarters Up for Sale. *The New York Times*. The New York Times, 19 June 2013. Web. 06 June 2016. <http://www.nytimes.com/2013/06/20/arts/design/sothebys-considers-putting-its-headquarters-up-for-sale.html>

<sup>7</sup> Kinsella, Eileen. "Singapore's Shanda To Increase Sotheby's Stake - News Artnet." *Artnet News*. 19 May 2016. Web. 24 May 2016. <<https://news.artnet.com/art-world/singaporean-company-shanda-ups-sothebys-stake-500396>>.

<sup>8</sup> Lumbreras, Javier. *The Art of Collecting Art*. Barcelona: Fomento Cultural Banamex, 2011. Print. p. 203



*Disclaimer: At the time of publication, the author(s) held no long or short positions in the Sotheby's stock.*

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