

SOTHEBYS  
Form 10-Q  
August 08, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 30, 2014  
Commission File Number 1-9750  
(Exact name of registrant as specified in its charter)

Delaware	38-2478409
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1334 York Avenue	10021
New York, New York	(Zip Code)
(Address of principal executive offices)	
Registrant's telephone number, including area code: (212) 606-7000	

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of the Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

As of July 31, 2014, there were 68,990,448 outstanding shares of Common Stock, par value \$0.01 per share, of the registrant.

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## PART I: FINANCIAL INFORMATION

## ITEM 1: FINANCIAL STATEMENTS

## SOTHEBY'S

## CONDENSED CONSOLIDATED INCOME STATEMENTS

(UNAUDITED)

(Thousands of dollars, except per share data)

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Revenues:				
Agency	\$316,187	\$294,943	\$439,315	\$389,118
Principal	8,733	2,122	34,734	3,205
Finance	8,140	5,561	13,822	10,494
License fees	2,462	2,090	4,159	3,276
Other	295	152	598	520
Total revenues	335,817	304,868	492,628	406,613
Expenses:				
Agency direct costs	31,617	31,260	42,054	39,709
Cost of Principal revenues	7,518	3,998	32,020	4,698
Cost of Finance revenues	2,024	—	2,734	—
Marketing	4,564	5,859	7,697	10,546
Salaries and related	97,833	81,265	163,589	141,960
General and administrative	38,210	44,371	75,542	88,382
Depreciation and amortization	5,066	4,801	10,213	9,317
Special charges	18,554	—	24,257	—
Total expenses	205,386	171,554	358,106	294,612
Operating income	130,431	133,314	134,522	112,001
Interest income	402	1,441	818	1,827
Interest expense	(8,768)	) (12,137	) (17,551	) (24,652
Other income (expense)	694	) (168	) (748	) 1,531
Income before taxes	122,759	122,450	117,041	90,707
Equity in earnings (losses) of investees, net of taxes	230	) (14	) 384	) (12
Income tax expense	45,344	30,707	45,675	21,311
Net income	77,645	91,729	71,750	69,384
Less: Net income attributable to noncontrolling interest	(13	) —	(232	) —
Net income attributable to Sotheby's	\$77,632	\$91,729	\$71,518	\$69,384
Basic earnings per share - Sotheby's common shareholders	\$1.12	\$1.34	\$1.02	\$1.02
Diluted earnings per share - Sotheby's common shareholders	\$1.11	\$1.33	\$1.01	\$1.00
Weighted average basic shares outstanding	68,938	68,306	69,041	68,129
Weighted average diluted shares outstanding	69,491	68,889	69,619	68,990
Cash dividends paid per common share	\$0.10	\$—	\$4.54	\$—

See accompanying Notes to Condensed Consolidated Financial Statements



SOTHEBY'S  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(UNAUDITED)  
(Thousands of dollars)

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Net income	\$77,645	\$91,729	\$71,750	\$69,384
Other comprehensive income (loss):				
Cumulative foreign currency translation adjustments, net of taxes of (\$353) and (\$830) for the three and six months ended June 30, 2013	4,029	4,783	5,497	(19,317 )
Reclassification of cumulative translation adjustment included in net income	—	—	2,058	—
Amortization of previously unrecognized net pension losses included in net income, net of taxes of \$120, \$82, \$237, and \$165	479	276	951	555
Other comprehensive income (loss)	4,508	5,059	8,506	(18,762 )
Comprehensive income	82,153	96,788	80,256	50,622
Less: Comprehensive income attributable to noncontrolling interest	(13 )	—	(232 )	—
Comprehensive income attributable to Sotheby's	\$82,140	\$96,788	\$80,024	\$50,622

See accompanying Notes to Condensed Consolidated Financial Statements

SOTHEBY'S  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)  
(Thousands of dollars)

	June 30, 2014	December 31, 2013	June 30, 2013
<b>A S S E T S</b>			
Current Assets:			
Cash and cash equivalents	\$576,445	\$721,315	\$699,557
Restricted cash	56,656	32,146	16,648
Accounts receivable, net of allowance for doubtful accounts of \$6,995, \$6,939, and \$6,203	993,302	812,582	882,097
Notes receivable, net of allowance for credit losses of \$1,001, \$1,746, and \$1,577	96,883	176,529	100,836
Inventory	218,878	192,140	87,060
Deferred income taxes and income tax receivable	41,336	12,385	36,511
Prepaid expenses and other current assets	27,633	25,176	22,819
Total Current Assets	2,011,133	1,972,273	1,845,528
Notes receivable	510,905	336,896	340,556
Fixed assets, net of accumulated depreciation and amortization of \$188,273, \$178,841, and \$166,721	373,476	379,399	371,013
Goodwill and other intangible assets, net of accumulated amortization of \$6,415, \$6,484, and \$6,132	14,914	14,850	14,474
Equity method investments	10,862	11,040	11,138
Deferred income taxes and income tax receivable	38,836	55,520	52,231
Trust assets related to deferred compensation liability	52,041	53,231	50,051
Pension asset	41,525	37,284	19,555
Other long-term assets	19,309	33,053	38,804
Total Assets	\$3,073,001	\$2,893,546	\$2,743,350
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current Liabilities:			
Due to consignors	\$1,000,029	\$922,275	\$890,296
Current portion of long-term debt, net	3,730	3,630	3,532
Accounts payable and accrued liabilities	185,245	176,709	140,801
Client deposit	—	—	20,000
Accrued and deferred income taxes	46,808	26,040	23,045
Other current liabilities	16,068	13,835	9,802
Total Current Liabilities	1,251,880	1,142,489	1,087,476
Credit facility borrowings	345,000	—	—
Long-term debt, net	515,031	515,148	515,180
Accrued and deferred income taxes	21,182	22,392	23,415
Deferred compensation liability	51,350	51,831	47,861
Other long-term liabilities	11,413	22,021	21,813
Total Liabilities	2,195,856	1,753,881	1,695,745
Commitments and contingencies (see Note 9)			
Shareholders' Equity:			
Common Stock, \$0.01 par value	695	691	683
Authorized shares—200,000,000			
Issued shares—69,525,947, 69,131,892, and 68,337,055			

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Outstanding shares— 68,967,776, 69,131,892, and 68,337,055			
Additional paid-in capital	394,261	387,477	372,050
Treasury stock, at cost: 558,171 shares at June 30, 2014	(25,000	) —	—
Retained earnings	537,565	790,603	743,735
Accumulated other comprehensive loss	(30,947	) (39,453	) (69,137 )
Total Shareholders' Equity	876,574	1,139,318	1,047,331
Noncontrolling interest	571	347	274
Total Equity	877,145	1,139,665	1,047,605
Total Liabilities and Shareholders' Equity	\$3,073,001	\$2,893,546	\$2,743,350

See accompanying Notes to Condensed Consolidated Financial Statements

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SOTHEBY'S  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)  
(Thousands of dollars)

	Six Months Ended	
	June 30, 2014	June 30, 2013
Operating Activities:		
Net income attributable to Sotheby's	\$71,518	\$69,384
Adjustments to reconcile net income attributable to Sotheby's to net cash (used) provided by operating activities:		
Depreciation and amortization	10,213	9,317
Loss from cumulative translation adjustment upon liquidation of foreign subsidiary	2,058	—
Deferred income tax expense	11,980	7,513
Share-based payments	12,895	9,670
Net pension benefit	(350)	(572)
Inventory writedowns and bad debt provisions	3,316	4,600
Amortization of debt discount	1,782	5,579
Excess tax benefits from share-based payments	(3,625)	(2,715)
Other	982	106
Changes in assets and liabilities:		
Accounts receivable	(192,351)	(309,235)
Due to consignors	50,770	287,892
Inventory	(34,495)	(111)
Prepaid expenses and other current assets	(4,872)	(269)
Other long-term assets	(1,391)	(282)
Income tax receivable and deferred income tax assets	(22,405)	(10,136)
Accrued income taxes and deferred income tax liabilities	20,098	459
Accounts payable and accrued liabilities and other liabilities	10,318	21,712
Net cash (used) provided by operating activities	(63,559)	92,912
Investing Activities:		
Funding of notes receivable	(297,903)	(114,750)
Collections of notes receivable	247,234	151,659
Capital expenditures	(3,634)	(9,141)
Distributions from equity investees	875	—
(Increase) decrease in restricted cash	(24,822)	14,999
Proceeds from the sale of equity method investment	125	800
Net cash (used) provided by investing activities	(78,125)	43,567
Financing Activities:		
Proceeds from credit facility borrowings	345,000	—
Repayment of Convertible Notes	—	(197,371)
Proceeds from the settlement of Convertible Note Hedges	—	15,503
Repayments of York Property Mortgage	(1,799)	(1,456)
Repurchase of common stock	(25,000)	—
Dividends paid	(317,702)	—
Contribution from noncontrolling interest	—	322
Proceeds from exercise of employee stock options	967	2,529
Excess tax benefits from share-based payments	3,625	2,715

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Funding of employee tax obligations upon the vesting of share-based payments	(11,835	) (11,412	)
Net cash used by financing activities	(6,744	) (189,170	)
Effect of exchange rate changes on cash and cash equivalents	3,558	(16,099	)
Decrease in cash and cash equivalents	(144,870	) (68,790	)
Cash and cash equivalents at beginning of period	721,315	768,347	
Cash and cash equivalents at end of period	\$576,445	\$699,557	

Supplemental information on non-cash investing and financing activities:

See Note 5 for information regarding non-cash transfers between Accounts Receivable (net) and Notes Receivable (net).

See accompanying Notes to Condensed Consolidated Financial Statements

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SOTHEBY'S  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

1. Basis of Presentation

The Condensed Consolidated Financial Statements included herein have been prepared by Sotheby's pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles ("GAAP") in the United States of America (the "U.S.") have been condensed or omitted from this report, as is permitted by such rules and regulations; however, the management of Sotheby's believes that the disclosures herein are adequate to make the information presented not misleading and that all adjustments necessary for a fair presentation of the Condensed Consolidated Financial Statements are reflected in the interim periods presented. It is suggested that these Condensed Consolidated Financial Statements be read in conjunction with the financial statements and notes thereto included in Sotheby's 2013 Annual Report on Form 10-K.

The Condensed Consolidated Financial Statements include the accounts of Sotheby's, its wholly-owned subsidiaries, and Sotheby's Beijing Auction Co., Ltd ("Sotheby's Beijing"), a joint venture formed in September 2012 in which Sotheby's has a controlling 80% ownership interest. The net income attributable to the minority owner of Sotheby's Beijing, which was not material prior to 2014, is reported as "Net Income Attributable to Noncontrolling Interest" in the Condensed Consolidated Income Statements and the non-controlling 20% ownership interest is reported as "Noncontrolling Interest" within the Equity section of the Condensed Consolidated Balance Sheets.

2. Seasonality of Business

The worldwide art auction market has two principal selling seasons, which generally occur in the second and fourth quarters of the year. In the aggregate, second and fourth quarter Net Auction Sales (which represents the hammer price of property sold at auction) represented 83% and 84% of total Net Auction Sales in 2013 and 2012, respectively, with auction commission revenues comprising approximately 81% of Sotheby's total revenues in those years. Accordingly, Sotheby's financial results are seasonal, with peak revenues and operating income generally occurring in the second and fourth quarters. Consequently, first and third quarter results have historically reflected lower revenues when compared to the second and fourth quarters and, typically, a net loss due to the fixed nature of many of Sotheby's operating expenses.

3. Earnings Per Share

Basic earnings per share—Basic earnings per share attributable to Sotheby's common shareholders is computed under the two-class method using the weighted average number of common shares outstanding during the period. The two-class method requires that the amount of net income attributable to participating securities be deducted from consolidated net income in the computation of basic earnings per share. In periods with a net loss, the net loss attributable to participating securities is not deducted from consolidated net loss in the computation of basic loss per share as the impact would be anti-dilutive. Sotheby's only participating securities are unvested restricted stock units, which have non-forfeitable rights to dividends.

Diluted earnings per share—Diluted earnings per share attributable to Sotheby's common shareholders is computed in a similar manner to basic earnings per share under the two-class method, using the weighted average number of common shares outstanding during the period and, if dilutive, the weighted average number of potential common shares outstanding during the period. Sotheby's potential common shares include unvested performance share units held by employees, incremental common shares issuable upon the assumed exercise of employee stock options, and deferred stock units held by members of the Board of Directors. In 2013, Sotheby's potential common shares also included the net shares that would have been delivered to settle the premium upon assumed conversion of then-outstanding convertible debt, as well as the net shares that would have been issued upon the exercise of then-outstanding common stock warrants. (See Note 6 for information on Sotheby's 3.125% Convertible Notes, which were settled in June 2013, and the related common stock warrants that were settled in the fourth quarter of 2013. See Note 12 for information on Sotheby's share-based payment programs.)

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For the three and six months ended June 30, 2014, 1.1 million and 1.2 million potential common shares, respectively, related to unvested performance share units were excluded from the computation of diluted earnings per share as the profitability targets inherent in such awards were not achieved as of the balance sheet date. For the three and six months ended June 30, 2013, 1.3 million and 1.5 million potential common shares, respectively, related to unvested performance share units were excluded from the computation of diluted earnings per share as the profitability targets inherent in such awards were not achieved as of the balance sheet date.

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The table below summarizes the computation of basic and diluted earnings per share for the three and six months ended June 30, 2014 and 2013 (in thousands, except per share amounts):

Three Months Ended  
June 30,