

SOTHEBYS
Form 10-Q
November 09, 2011
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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 September 30, 2011

Commission File Number 1-9750

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

38-2478409
(I.R.S. Employer
Identification No.)

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1334 York Avenue

New York, New York
(Address of principal executive offices)

10021
(Zip Code)

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

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

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 October 31, 2011, there were 67,554,228 outstanding shares of Common Stock, par value \$0.01 per share, of the registrant.

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Table of Contents**PART I: FINANCIAL INFORMATION****ITEM 1: FINANCIAL STATEMENTS****SOTHEBY S****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(UNAUDITED)****(Thousands of dollars, except per share data)**

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2011 | September 30, 2010 | September 30, 2011 | September 30, 2010 |
| Revenues: | | | | |
| Auction and related revenues | \$ 52,916 | \$ 55,104 | \$ 516,841 | \$ 420,532 |
| Finance revenues | 2,923 | 1,932 | 9,022 | 6,568 |
| Dealer revenues | 591 | 14,991 | 16,848 | 25,848 |
| License fee revenues | 1,408 | 941 | 4,119 | 2,775 |
| Other revenues | 372 | 92 | 757 | 626 |
| Total revenues | 58,210 | 73,060 | 547,587 | 456,349 |
| Expenses: | | | | |
| Direct costs of services | 5,083 | 4,548 | 40,295 | 32,578 |
| Dealer cost of sales | 6,012 | 14,990 | 20,267 | 23,305 |
| Marketing expenses | 2,803 | 2,520 | 10,639 | 8,736 |
| Salaries and related costs | 45,724 | 46,722 | 194,186 | 167,661 |
| General and administrative expenses | 37,404 | 29,723 | 110,788 | 93,342 |
| Depreciation and amortization expense | 4,461 | 3,852 | 12,803 | 12,304 |
| Restructuring charges, net | 2,208 | (148) | 4,476 | (50) |
| Total expenses | 103,695 | 102,207 | 393,454 | 337,876 |
| Operating (loss) income | (45,485) | (29,147) | 154,133 | 118,473 |
| Interest income | 530 | 389 | 3,667 | 1,127 |
| Interest expense | (10,330) | (11,840) | (31,277) | (35,176) |
| Extinguishment of debt, net | (1,529) | | (1,529) | |
| Other (expense) income | (1,086) | 2,116 | (1,455) | 1,244 |
| (Loss) income before taxes | (57,900) | (38,482) | 123,539 | 85,668 |
| Equity in (losses) earnings of investees, net of taxes | (25) | 173 | 28 | 417 |
| Income tax (benefit) expense | (28,206) | (18,948) | 23,631 | 21,384 |
| Net (loss) income | \$ (29,719) | \$ (19,361) | \$ 99,936 | \$ 64,701 |
| Basic (loss) earnings per share - Sotheby s common shareholders (see Note 3) | \$ (0.44) | \$ (0.29) | \$ 1.47 | \$ 0.95 |

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| | | | | |
|---|-----------|-----------|---------|---------|
| Diluted (loss) earnings per share - Sotheby's common shareholders (see Note 3) | \$ (0.44) | \$ (0.29) | \$ 1.43 | \$ 0.94 |
| Weighted average basic shares outstanding | 67,410 | 66,377 | 67,263 | 66,238 |
| Weighted average diluted shares outstanding | 67,410 | 66,377 | 69,075 | 67,025 |
| Cash dividends paid per common share | \$ 0.05 | \$ 0.05 | \$ 0.15 | \$ 0.15 |

See accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents**SOTHEBY S****CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)****(Thousands of dollars)**

| | September 30, 2011 | December 31, 2010 | September 30, 2010 |
|---|-----------------------|----------------------|-----------------------|
| ASSETS | | | |
| Current Assets: | | | |
| Cash and cash equivalents | \$ 542,400 | \$ 483,663 | \$ 345,617 |
| Restricted cash | 22,703 | 18,812 | 24,589 |
| Accounts receivable, net of allowance for doubtful accounts of \$5,076, \$4,716 and \$4,558 | 375,973 | 681,800 | 308,983 |
| Notes receivable, net of allowance for credit losses of \$874, \$971 and \$1,133 | 67,953 | 101,850 | 76,072 |
| Inventory | 117,450 | 126,534 | 133,686 |
| Deferred income taxes | 11,154 | 15,057 | 14,019 |
| Income tax receivable | 31,056 | 5,108 | 16,784 |
| Prepaid expenses and other current assets | 24,153 | 17,580 | 20,375 |
| Total Current Assets | 1,192,842 | 1,450,404 | 940,125 |
| Notes receivable | 167,417 | 175,423 | 102,193 |
| Fixed assets, net of accumulated depreciation and amortization of \$156,315, \$147,280 and \$145,714 | 372,160 | 372,692 | 369,982 |
| Goodwill and other intangible assets, net of accumulated amortization of \$6,171, \$5,846 and \$5,853 | 14,797 | 15,012 | 15,218 |
| Equity method investments | 14,886 | 15,154 | 15,917 |
| Deferred income taxes | 41,570 | 39,703 | 39,862 |
| Trust assets related to deferred compensation liability | 40,062 | 39,024 | 37,523 |
| Pension asset | 61,541 | 55,180 | 17,554 |
| Other long-term assets | 14,489 | 16,036 | 21,725 |
| Total Assets | \$ 1,919,764 | \$ 2,178,628 | \$ 1,560,099 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| Current Liabilities: | | | |
| Due to consignors | \$ 367,235 | \$ 675,586 | \$ 224,996 |
| Accounts payable and accrued liabilities | 62,256 | 66,846 | 40,135 |
| Accrued salaries and related costs | 59,606 | 85,471 | 48,234 |
| Accrued income taxes | 27,456 | 40,109 | 21,195 |
| Deferred income taxes | 757 | 282 | 603 |
| Other current liabilities | 9,837 | 9,090 | 10,596 |
| Total Current Liabilities | 527,147 | 877,384 | 345,759 |
| Long-term debt, net | 462,601 | 472,862 | 518,934 |
| Deferred income taxes | 8,265 | 8,913 | 452 |
| Accrued income taxes | 6,626 | 4,932 | 4,695 |

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| | | | |
|---|---------------------|---------------------|---------------------|
| Deferred compensation liability | 38,068 | 36,176 | 34,484 |
| Other long-term liabilities | 6,729 | 6,853 | 7,302 |
| Total Liabilities | 1,049,436 | 1,407,120 | 911,626 |
| Commitments and contingencies (see Note 9) | | | |
| Shareholders' Equity: | | | |
| Common Stock, \$0.01 par value | 675 | 673 | 667 |
| Authorized shares 200,000,000 | | | |
| Issued and outstanding shares 67,554,228, 67,320,667 and 67,064,701 | | | |
| Additional paid-in capital | 350,895 | 345,066 | 334,701 |
| Retained earnings | 535,206 | 444,717 | 351,972 |
| Accumulated other comprehensive loss | (16,448) | (18,948) | (38,867) |
| Total Shareholders' Equity | 870,328 | 771,508 | 648,473 |
| Total Liabilities and Shareholders' Equity | \$ 1,919,764 | \$ 2,178,628 | \$ 1,560,099 |

See accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents**SOTHEBY S****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)****(Thousands of dollars)**

| | Nine Months Ended | |
|---|--------------------------|----------------------|
| | September 30, | September 30, |
| | 2011 | 2010 |
| Operating Activities: | | |
| Net income | \$ 99,936 | \$ 64,701 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 12,803 | 12,304 |
| Loss on extinguishment of debt | 1,529 | |
| Deferred income tax expense | 547 | 8,716 |
| Share-based payments | 14,196 | 15,978 |
| Net pension benefit | (4,197) | (2,752) |
| Asset provisions | 11,131 | 7,201 |
| Amortization of discount on debt | 8,578 | 8,280 |
| Excess tax benefits from share-based payments | (7,242) | |
| Other | 770 | 370 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 291,939 | 54,945 |
| Due to consignors | (306,247) | (121,221) |
| Inventory | (341) | (389) |
| Prepaid expenses and other current assets | (8,313) | (1,602) |
| Other long-term assets | 249 | 3,262 |
| Income tax receivable and deferred income tax assets | (17,467) | (11,038) |
| Accrued income taxes and deferred income tax liabilities | (10,969) | 10,218 |
| Accounts payable and accrued liabilities and other liabilities | (28,013) | 4,724 |
| Net cash provided by operating activities | 58,889 | 53,697 |
| Investing Activities: | | |
| Funding of notes receivable | (124,016) | (156,222) |
| Collections of notes receivable | 184,159 | 152,391 |
| Capital expenditures | (12,977) | (11,597) |
| Distributions from equity investees | 320 | 1,850 |
| Increase in restricted cash | (3,621) | (8,079) |
| Net cash provided (used) by investing activities | 43,865 | (21,657) |
| Financing Activities: | | |
| Repayments of Convertible Notes | (22,465) | |
| Proceeds from the settlement of Convertible Note Hedges | 4,350 | |
| Dividends paid | (10,296) | (10,116) |
| Repayments of York Property Mortgage | (2,044) | (446) |
| Proceeds from exercise of employee stock options | 2,566 | 9,980 |
| Excess tax benefits from share-based payments | 7,242 | |

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| | | |
|--|------------|------------|
| Funding of employee tax obligations upon the vesting of share-based payments | (18,575) | (6,601) |
| Net cash used by financing activities | (39,222) | (7,183) |
| Effect of exchange rate changes on cash and cash equivalents | (4,795) | (819) |
| Increase in cash and cash equivalents | 58,737 | 24,038 |
| Cash and cash equivalents at beginning of period | 483,663 | 321,579 |
| Cash and cash equivalents at end of period | \$ 542,400 | \$ 345,617 |

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, management of Sotheby's believes that the disclosures herein are adequate to make the information presented not misleading. It is suggested that these Condensed Consolidated Financial Statements be read in conjunction with the financial statements and notes thereto included in Sotheby's 2010 Annual Report on Form 10-K.

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. Accordingly, Sotheby's auction business is seasonal, with peak revenues and operating income generally occurring in those quarters. Consequently, first and third quarter results have historically reflected a lower volume of auction activity 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. (Loss) Earnings Per Share

Basic (loss) earnings per share Basic (loss) 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 participating securities include unvested share-based payments to employees that have non-forfeitable rights to dividends such as restricted stock and restricted stock units.

Diluted (loss) earnings per share Diluted (loss) earnings per share attributable to Sotheby's common shareholders is computed in a similar manner to basic (loss) earnings per share under the two-class method, using the weighted average number of common shares outstanding during the period and, if dilutive, potential common shares outstanding during the period. Sotheby's potential common shares include the following:

Unvested performance share units and incremental common shares issuable upon the exercise of stock options. Such potential common shares are included in the computation of diluted earnings per share using the treasury stock method.

Deferred stock units issued pursuant to the Sotheby's Stock Compensation Plan for Non-Employee Directors.

In reporting periods during which the average trading price of Sotheby's Common Stock exceeds the \$34 per share conversion price of its 3.125% Convertible Notes (the "Convertible Notes"), the net shares that would be delivered to settle the conversion premium assuming all of the Convertible Notes are redeemed.

In reporting periods during which the average trading price of Sotheby's Common Stock exceeds the \$44.905 per share exercise price of the warrants that were sold in conjunction with the issuance of the Convertible Notes (the "Warrants"), the net shares that would be delivered to settle the Warrants as calculated under the treasury stock method.

During each of the first three quarters of 2011, the average trading price of Sotheby's Common Stock exceeded the \$34 per share conversion price of the Convertible Notes. As a result, for the nine months ended September 30, 2011, 1.1 million shares of Sotheby's Common Stock were

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included in the calculation of weighted average diluted shares outstanding related to the Convertible Notes. (See Note 6 for additional information related to the Convertible Notes.)

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During the first quarter of 2011, the average trading price of Sotheby's Common Stock exceeded the \$44.905 per share exercise price of the Warrants. However, the average trading price of Sotheby's Common Stock did not exceed the exercise price of the Warrants in the second and third quarters of 2011. As a result, for the three and nine months ended September 30, 2011, zero and 21,000 shares of Sotheby's Common Stock, respectively, were included in the calculation of weighted average diluted shares outstanding related to the Warrants.

For the three months ended September 30, 2011 and 2010, 2.5 million and 1.9 million potential common shares were excluded from the computation of diluted earnings per share. For the nine months ended September 30, 2011 and 2010, no potential common shares were excluded from the computation of diluted earnings per share.

The table below summarizes the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2011 and 2010 (in thousands of dollars, except per share amounts):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Basic: | | | | |
| <i>Numerator:</i> | | | | |
| Net (loss) income attributable to Sotheby's | \$ (29,719) | \$ (19,361) | \$ 99,936 | \$ 64,701 |
| Less: Net income attributable to participating securities | N/A | N/A | 1,169 | 1,575 |
| Net (loss) income attributable to Sotheby's common shareholders | \$ (29,719) | \$ (19,361) | \$ 98,767 | \$ 63,126 |
| <i>Denominator:</i> | | | | |
| Weighted average common shares outstanding | 67,410 | 66,377 | 67,263 | 66,238 |
| Basic (loss) earnings per share - Sotheby's common shareholders | \$ (0.44) | \$ (0.29) | \$ 1.47 | \$ 0.95 |
| Diluted: | | | | |
| <i>Numerator:</i> | | | | |
| Net (loss) income attributable to Sotheby's | \$ (29,719) | \$ (19,361) | \$ 99,936 | \$ 64,701 |
| Less: Net income attributable to participating securities | N/A | N/A | 1,142 | 1,560 |
| Net (loss) income attributable to Sotheby's common shareholders | \$ (29,719) | \$ (19,361) | \$ 98,794 | \$ 63,141 |
| <i>Denominator:</i> | | | | |
| Weighted average common shares outstanding | 67,410 | 66,377 | 67,263 | 66,238 |
| Weighted average dilutive potential common shares outstanding | N/A | N/A | 1,812 | 787 |
| Denominator for calculation of diluted earnings per share | 67,410 | 66,377 | 69,075 | 67,025 |
| Diluted (loss) earnings per share - Sotheby's common shareholders | \$ (0.44) | \$ (0.29) | \$ 1.43 | \$ 0.94 |

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Sotheby's operations are organized under three segments—Auction, Finance and Dealer. The table below presents Sotheby's revenues and (loss) income before taxes by segment for the three and nine months ended September 30, 2011 and 2010 (in thousands of dollars):

| | Reconcil | Reconcil | Reconcil | Reconcil | Reconcil | Reconcil |
|--|-------------|-----------|------------|-----------|-------------------|-------------|
| | Auction | Finance | Dealer | All Other | Reconciling items | Total |
| Three months ended September 30, 2011 | | | | | | |
| Revenues | \$ 52,916 | \$ 3,507 | \$ 591 | \$ 1,780 | (\$ 584) | \$ 58,210 |
| Segment (loss) income before taxes | (\$ 51,399) | \$ 752 | (\$ 7,006) | \$ 1,238 | (\$ 1,485) | (\$ 57,900) |
| Three months ended September 30, 2010 | | | | | | |
| Revenues | \$ 55,104 | \$ 3,499 | \$ 14,991 | \$ 1,033 | (\$ 1,567) | \$ 73,060 |
| Segment (loss) income before taxes | (\$ 42,034) | \$ 4,365 | (\$ 1,236) | \$ 693 | (\$ 270) | (\$ 38,482) |
| Nine months ended September 30, 2011 | | | | | | |
| Revenues | \$ 516,841 | \$ 12,193 | \$ 16,848 | \$ 4,876 | (\$ 3,171) | \$ 547,587 |
| Segment income (loss) before taxes | \$ 120,424 | \$ 9,075 | (\$ 7,979) | \$ 3,601 | (\$ 1,582) | \$ 123,539 |
| Nine months ended September 30, 2010 | | | | | | |
| Revenues | \$ 420,532 | \$ 12,240 | \$ 25,848 | \$ 3,401 | (\$ 5,672) | \$ 456,349 |
| Segment income (loss) before taxes | \$ 76,410 | \$ 10,374 | (\$ 2,561) | \$ 2,089 | (\$ 644) | \$ 85,668 |

For the three and nine months ended September 30, 2011, Finance segment income before taxes includes a \$1.7 million non-operating loss and a \$0.8 million non-operating gain, respectively, related to the remeasurement of foreign currency denominated client loan and intercompany balances. For the three and nine months ended September 30, 2010, Finance segment income before taxes includes a \$2 million non-operating gain related to the remeasurement of a foreign currency denominated client loan and intercompany balances.

The reconciling items related to Revenues represent charges from the Finance segment to the Auction segment for short-term, interest-free or other below market consignor advances with maturities typically ranging between 3 and 6 months (see Note 5).

The activities of Sotheby's Dealer segment principally include the activities of Noortman Master Paintings (NMP), a wholly-owned art dealer. In the third quarter of 2011, following the fifth anniversary of the acquisition of NMP and the expiration of the related financial performance targets (see Note 12), management initiated a plan to restructure NMP's business and sales strategy. Historically, NMP has principally specialized in sales of Dutch and Flemish Old Master Paintings, as well as French Impressionist and Post-Impressionist paintings, with a large number of paintings held in inventory at various price points. However, in the future, NMP will greatly reduce its inventory of lower valued Old Master Paintings and shift its focus to a select group of high-valued works of art. Accordingly, NMP will offer a large collection of lower valued works at various auction houses in the fourth quarter of 2011. In the ordinary course of NMP's business, these objects would have been held for a longer period and sold in privately negotiated transactions. As a result of the new strategy described above and due in part to a general weakening of the private dealer market for certain categories of lower valued Old Master Paintings, as well as a shift in the collecting tastes of NMP's clients, inventory writedowns of \$5.7 million were recorded in the third quarter of 2011. For the nine months ended September 30, 2011, Dealer segment inventory writedowns totaled \$8.3 million.

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The reconciling items related to segment (loss) income before taxes are shown in the table below, which presents total segment (loss) income before taxes, as well as a reconciliation of total segment (loss) income before taxes for the three and nine months ended September 30, 2011 and 2010 (in thousands of dollars):

| | Three Months Ended September 30, 2011 | | Nine Months Ended September 30, 2010 | |
|--|---------------------------------------|--------------------|--------------------------------------|------------------|
| Auction | \$ (51,399) | \$ (42,034) | \$ 120,424 | \$ 76,410 |
| Finance | 752 | 4,365 | 9,075 | 10,374 |
| Dealer | (7,006) | (1,236) | (7,979) | (2,561) |
| All Other | 1,238 | 693 | 3,601 | 2,089 |
| Segment (loss) income before taxes | (56,415) | (38,212) | 125,121 | 86,312 |
| Unallocated amounts and reconciling items: | | | | |
| Extinguishment of debt (see Note 6) | (1,529) | | (1,529) | |
| Equity in losses (earnings) of investees * | 44 | (270) | (53) | (644) |
| (Loss) income before taxes | \$ (57,900) | \$ (38,482) | \$ 123,539 | \$ 85,668 |

* Represents Sotheby's pre-tax share of earnings related to its equity investees. Such amounts are included in the table above in (loss) income before taxes for the Dealer segment, but are presented net of taxes in the Condensed Consolidated Statements of Operations.

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The table below presents assets for Sotheby's segments, as well as a reconciliation of segment assets to consolidated assets as of September 30, 2011, December 31, 2010 and September 30, 2010 (in thousands of dollars):

| | September 30, 2011 | December 31, 2010 | September 30, 2010 |
|---|---------------------|---------------------|---------------------|
| Auction | \$ 1,512,909 | \$ 1,784,045 | \$ 1,241,722 |
| Finance | 226,411 | 244,463 | 156,671 |
| Dealer | 95,379 | 88,845 | 89,601 |
| All Other | 1,285 | 1,407 | 1,440 |
| Total segment assets | 1,835,984 | 2,118,760 | 1,489,434 |
| Unallocated amounts: | | | |
| Deferred tax assets and income tax receivable | 83,780 | 59,868 | 70,665 |
| Consolidated assets | \$ 1,919,764 | \$ 2,178,628 | \$ 1,560,099 |

5. Receivables

Accounts Receivable In its role as auctioneer, Sotheby's represents sellers of artworks by accepting property on consignment and by matching sellers to buyers through the auction process. Sotheby's invoices the buyer for the purchase price of the property (including the commission owed by the buyer), collects payment from the buyer and remits to the seller the net sale proceeds after deducting its commissions, expenses and applicable taxes and royalties. Sotheby's commissions include those paid by the buyer (buyer's premium) and those paid by the seller (seller's commission) (collectively, auction commission revenue), both of which are calculated as a percentage of the hammer price of the property sold at auction.

Under Sotheby's standard payment terms, payments from buyers are due no more than 30 days from the sale date and consignor payments are made 35 days from the sale date. However, extended payment terms are sometimes provided to buyers in order to support and market a sale. Such terms typically extend the payment due date from 30 days to a date that is no greater than one year from the sale date. When providing extended payment terms, Sotheby's attempts to match the timing of receipt from the buyer with payment to the consignor, but is not always successful in doing so.

Under the standard terms and conditions of its auction sales, Sotheby's is not obligated to pay consignors for property that has not been paid for by buyers. If a buyer defaults on payment, the sale may be cancelled and the property will be returned to the consignor. Alternatively, the consignor may reoffer the property at a future auction or negotiate a private sale. However, in certain limited instances and subject to approval under Sotheby's policy, the consignor may be paid before payment is collected from the buyer and/or the buyer may be allowed to take possession of the property before payment is received. In situations when the buyer takes possession of the property before payment is received, Sotheby's is liable to the seller for the net sale proceeds whether or not the buyer makes payment. As of September 30, 2011, net Accounts Receivable of approximately \$376 million includes \$64.8 million related to transactions in which the buyer has taken possession of the property before making payment to Sotheby's. Management believes that adequate allowances have been established to provide for potential losses on any uncollected amounts.

As of September 30, 2011, \$42.4 million, or 11%, of net Accounts Receivable was due from one buyer. Sotheby's has possession of the property securing this receivable balance and has not paid the consignor of the property. Sotheby's expects to collect the full amount of this receivable balance within twelve months of the July 2011 sale date.

Notes Receivable Through its Finance segment, Sotheby's provides certain collectors and art dealers with financing secured by works of art that it either has in its possession or permits borrowers to possess. The Finance segment generally makes two types of secured loans: (1) advances secured by consigned property to borrowers who are contractually committed, in the near term, to sell the property at auction (a consignor advance); and (2) general purpose term loans secured by property not presently intended for sale (a term loan). A consignor advance allows a seller to receive funds upon consignment for an auction that will typically occur up to one year in the future, while preserving for the benefit of the seller the potential of the auction process. Term loans allow Sotheby's to establish or enhance mutually beneficial relationships with borrowers and are intended to generate future auction consignments, although such loans do not always result in consignments. Secured loans are typically made with full recourse against the borrower.

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The collection of secured loans can be adversely impacted by a decline in the art market in general or in the value of the particular collateral. In addition, in situations when there are competing claims on the collateral and/or when a borrower becomes subject to bankruptcy or insolvency laws, Sotheby's ability to realize on its collateral may be limited or delayed.

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Sotheby's target loan-to-value ratio (LTV), which is defined as the principal loan amount divided by the low auction estimate of the collateral, is 50% or lower. However, loans are sometimes made at an initial LTV higher than 50%. In addition, as a result of the periodic revaluation of loan collateral, the LTV of certain loans may increase above the 50% target due to decreases in the low auction estimates of the collateral. The revaluation of loan collateral is performed by Sotheby's specialists on an annual basis or more frequently if there is a material change in circumstances related to the loan or the disposal plans for the collateral. Management believes that the LTV ratio is the critical credit quality indicator for Finance segment secured loans. As of September 30, 2011 and 2010, the aggregate LTV of Finance segment secured loans was 44% and 39%, respectively. As of September 30, 2011, Finance segment secured loans with an LTV above 50% totaled \$126 million and represented 54% of net Notes Receivable. The collateral related to these loans has a low auction estimate of \$214 million. As of September 30, 2010, Finance segment secured loans with an LTV above 50% totaled \$79.5 million and the collateral related to these loans had a low auction estimate of \$118.8 million.

From 2008 through September 30, 2011, Sotheby's has recognized \$0.1 million of cumulative losses related to specific impaired Finance segment secured loans. The tables below provide other credit quality information regarding Finance segment secured loans as of September 30, 2011 and 2010 (in thousands of dollars):

| | \$234,106 September 30, 2011 | \$234,106 December 31, 2010 | \$234,106 September 30, 2010 |
|--|------------------------------------|-----------------------------------|------------------------------------|
| Total secured loans | \$ 234,106 | \$ 241,631 | \$ 169,016 |
| Loans past due | \$ 19,942 | \$ 23,888 | \$ 22,509 |
| Loans more than 90 days past due accruing interest | \$ 14,323 | \$ 19,663 | \$ 19,622 |
| Non-accrual loans | \$ | \$ 1,028 | \$ 1,034 |
| Impaired loans | \$ | \$ 137 | \$ 137 |

| | \$234,106 September 30, 2011 | \$234,106 December 31, 2010 | \$234,106 September 30, 2010 |
|--|------------------------------------|-----------------------------------|------------------------------------|
| Allowance for credit losses - impaired loans | \$ | \$ 137 | \$ 137 |
| Allowance for credit losses based on historical data | 874 | 834 | 996 |
| Total allowance for credit losses - secured loans | \$ 874 | \$ 971 | \$ 1,133 |

Sotheby's is obligated under the terms of certain auction guarantees (see Note 10) to advance a portion of the guaranteed amount prior to auction. Such Auction segment consignor advances are recorded on Sotheby's balance sheet within Notes Receivable. As of September 30, 2011 and 2010, Sotheby's had \$10 million and \$22.7 million of auction guarantee advances outstanding, respectively. On rare occasions, in order to attract future consignments, Sotheby's also makes unsecured loans to clients. The table above does not include unsecured loans of \$2.1 million and \$10.2 million as of September 30, 2011 and 2010, respectively.

Management considers a loan to be past due when principal payments are not paid in accordance with the stated terms of the loan. As of September 30, 2011, \$19.9 million of the net Notes Receivable balance was considered to be past due, of which \$14.3 million was more than 90 days past due and still accruing interest. The collateral related to these past due secured loans has a low auction estimate of approximately \$63.1 million. In consideration of the value of the collateral related to these loans, current collateral disposal plans and negotiations with the borrowers, management believes that the principal and interest amounts due for these loans will be collected.

A non-accrual loan is a loan for which future Finance Revenue is not recorded due to management's determination that it is probable that future interest on the loan is not collectible. Any cash receipts subsequently received on non-accrual loans are first applied to reduce the recorded principal balance of the loan, with any proceeds in excess of the principal balance then applied to interest owed by the borrower. The recognition of Finance Revenue may resume on a non-accrual loan if sufficient additional collateral is provided by the borrower or if management becomes aware of other circumstances that indicate that it is probable that the borrower will make future interest payments on the loan.

A loan is considered to be impaired when management determines that it is probable that a portion of the principal and interest owed by the borrower will not be recovered. If a loan is considered to be impaired, Finance Revenue is no longer recognized and bad debt expense is recorded for any principal or interest that is deemed uncollectible.

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As of December 31, 2010 and September 30, 2010, the balance of non-accrual loans was \$1 million, which included \$0.1 million of impaired loans.

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During the period January 1, 2010 to September 30, 2011, activity related to the allowance for credit losses is as follows (in thousands of dollars):

| | |
|--|----------|
| Allowance for credit losses as of January 1, 2010 | \$ 1,028 |
| Change in loan loss provision | (57) |
| Allowance for credit losses at December 31, 2010 | 971 |
| Change in loan loss provision | 40 |
| Write-offs | (137) |
| Allowance for credit losses as of September 30, 2011 | \$ 874 |

Finance segment loans are predominantly variable interest rate loans; however, short-term, interest-free advances with maturities typically ranging between 3 and 6 months are provided to certain consignors in order to secure high-value property for auctions and can represent a significant portion of the client loan portfolio as of the end of certain quarterly reporting periods in advance of peak selling seasons. For the three months ended September 30, 2011 and 2010, the weighted average interest rates earned on Notes Receivable were 5.9% and 5.1%, respectively. For the nine months ended September 30, 2011 and 2010, the weighted average interest rates earned on Notes Receivable were 5.2% and 5%, respectively. The carrying value of the loan portfolio approximates its fair value.

As of September 30, 2011, loans to entities related to one borrower totaled \$50.2 million, which comprised approximately 21% of the net Notes Receivable balance. As of September 30, 2011, a loan to one other borrower totaled \$30.6 million, which comprised approximately 13% of the net Notes Receivable balance.

6. Debt

Revolving Credit Facility On August 31, 2009, Sotheby's and certain of its wholly-owned subsidiaries (collectively, the Borrowers) entered into a credit agreement (the Credit Agreement) with an international syndicate of lenders led by General Electric Capital Corporation (GE Capital). The Credit Agreement was amended by Sotheby's, GE Capital and the lenders named therein (collectively, the Lenders) on November 23, 2010. This amendment, among other things, extended the maturity date of the Credit Agreement, reduced borrowing costs and fees, and provided additional flexibility to Sotheby's.

The following summary does not purport to be a complete summary of the Credit Agreement, as amended, and is qualified in its entirety by reference to the Credit Agreement and each of the respective amendments, copies of which were filed as exhibits to previous SEC filings. Terms used, but not defined in this summary, have the meanings set forth in the Credit Agreement and each of the respective amendments.

The Credit Agreement, as amended, provides for a \$200 million revolving credit facility (the Revolving Credit Facility), subject to a borrowing base, and has a feature whereby any time on or before March 1, 2014 the Borrowers may request, with Lenders' approval, to increase the borrowing capacity by an amount not to exceed \$50 million. In addition, up to \$10 million of the Revolving Credit Facility may be used to issue letters of credit. As of September 30, 2011, no borrowings were outstanding, and the amount of available borrowings under the Revolving Credit Facility was approximately \$103.2 million, as calculated under the borrowing base. Sotheby's has not borrowed or issued any letters of credit under the Revolving Credit Facility since its inception.

Borrowings under the Revolving Credit Facility are available in either Dollars to U.S. Borrowers or Pounds Sterling to United Kingdom (U.K.) Borrowers. The U.S. Borrowers and, subject to certain limitations, the U.K. Borrowers, are jointly and severally liable for all obligations under the Credit Agreement, as amended. In addition, certain subsidiaries of the Borrowers guarantee the obligations of the Borrowers under the Credit Agreement, as amended. The obligations under the Credit Agreement, as amended, are secured by liens on all or substantially all of the personal property of the Borrowers and the Guarantors.

Borrowings are, at the Borrowers' option, either Dollar Index Rate Loans (for U.S. Borrowers only) or LIBOR Rate Loans. Dollar Index Rate Loans bear interest at a rate per annum equal to (a) the highest of (i) the Prime Rate as quoted in *The Wall Street Journal*, (ii) the Federal Funds Rate plus 0.50%, or (iii) the LIBOR Rate plus 1.0%, plus (b) the Applicable Margin, as defined in the Credit Agreement, as amended, and which is generally 1.50% to 2.00% based upon the level of outstanding borrowings under the Revolving Credit Facility. The LIBOR Rate for Dollars or Sterling, as the case may be, for an interest period is equal to (x) the offered rate for deposits in such currency for a period equal to such interest period on the Reuters Screen LIBOR01 Page, plus (y) the Applicable Margin, as defined in the Credit Agreement, as amended, and

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which is generally 2.50% to 3.00% based upon the level of outstanding borrowings under the Revolving Credit Facility.

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The Credit Agreement, as amended, contains certain customary affirmative and negative covenants including, but not limited to, limitations on capital expenditures, limitations on net outstanding auction guarantees (auction guarantees less the impact of risk and reward sharing arrangements) and limitations on the use of proceeds from borrowings under the Credit Agreement, as amended. The Credit Agreement, as amended, also restricts quarterly dividend payments to the lesser of \$0.10 per share or \$8 million. However, the maximum level of quarterly dividend payments may be increased depending upon Sotheby's achievement of a certain Fixed Charge Coverage Ratio in any period. Management believes that Sotheby's is in compliance with the covenants and terms of the Credit Agreement, as amended.

The Credit Agreement, as amended, also contains certain financial covenants, which are only applicable during certain compliance periods. These financial covenants were not applicable for the twelve month period ended September 30, 2011.

The maturity date of the Credit Agreement, as amended, is September 1, 2014, subject to Sotheby's meeting certain liquidity requirements during the period commencing on December 15, 2012 and ending on the date Sotheby's 3.125% Convertible Notes are converted or discharged.

Long-Term Debt As of September 30, 2011, December 31, 2010 and September 30, 2010, Long-Term Debt consisted of the following (in thousands of dollars):

| | September 30, 2011 | December 31, 2010 | September 30, 2010 |
|--|-----------------------|----------------------|-----------------------|
| York Property Mortgage, net of unamortized discount of \$13,366, \$16,039 and \$16,921 | \$ 218,167 | \$ 217,538 | \$ 217,624 |
| Senior Notes, net of unamortized discount of \$791, \$898 and \$1,345 | 79,180 | 79,073 | 126,905 |
| Convertible Notes, net of unamortized discount of \$13,437, \$20,665 and \$22,552 | 168,431 | 179,335 | 177,448 |
| Less current portion: | | | |
| York Property Mortgage | (3,177) | (3,084) | (3,043) |
| Total Long-Term Debt | \$ 462,601 | \$ 472,862 | \$ 518,934 |

York Property Mortgage On February 6, 2009, Sotheby's purchased the land and building located at 1334 York Avenue, New York, New York (the York Property) from RFR Holding Corp. (RFR) for a purchase price of \$370 million. The York Property is home to Sotheby's sole North American auction salesroom and its principal North American exhibition space, as well as its corporate headquarters.

Sotheby's financed the \$370 million purchase price through an initial \$50 million cash payment made in conjunction with the signing of the related purchase and sale agreement on January 11, 2008, an \$85 million cash payment made when the purchase was consummated on February 6, 2009 and the assumption of an existing \$235 million mortgage on the York Property (the York Property Mortgage).

The York Property Mortgage matures on July 1, 2035, but has an optional pre-payment date of July 1, 2015 and bears an annual rate of interest of approximately 5.6%, which increases subsequent to July 1, 2015. It is Sotheby's current intention to either pre-pay or refinance the mortgage on or about July 1, 2015. In conjunction with the final accounting for the York Property purchase in February 2009, the York Property Mortgage was recorded on Sotheby's balance sheet at its \$212.1 million fair value. The fair value of the York Property Mortgage was computed using a discounted cash flow approach based on a market rate of interest, which was estimated by management. The resulting \$22.9 million debt discount is being amortized to interest expense over the remaining expected term of the loan. Sotheby's paid fees of \$2.4 million in conjunction with the assumption of the York Property Mortgage, which are also being amortized to Interest Expense over the remaining expected term of the loan. As of September 30, 2011, the fair value of the York Property Mortgage was approximately \$231 million and is based on a present value calculation utilizing an interest rate obtained from a third party source.

The York Property and the York Property Mortgage are held by 1334 York, LLC, a separate legal entity of Sotheby's that maintains its own books and records and whose results are ultimately consolidated into Sotheby's financial statements. The assets of 1334 York, LLC are not available to satisfy the obligations of other Sotheby's affiliates or any other entity.

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Senior Notes On June 17, 2008, Sotheby's issued \$150 million aggregate principal amount of 7.75% Senior Notes, due June 15, 2015. The net proceeds from the issuance of the Senior Notes were approximately \$145.9 million, after deducting the initial purchasers' discounts and fees. The Senior Notes have an effective interest rate of 8%. Interest on the Senior Notes is payable semi-annually in cash on June 15 and December 15 of each year.

Through December 31, 2010, Sotheby's had repurchased an aggregate principal amount of \$70 million of its Senior Notes for a purchase price of \$65.3 million. These repurchases have resulted in a life-to-date non-cash net gain of approximately \$2.5 million, net of fees, consisting of a \$7.8 million gain recognized in the fourth quarter of 2008, a \$1 million gain recognized in the first quarter of 2009 and a \$6.3 million loss recognized in the fourth quarter of 2010. There have been no Senior Notes repurchases in 2011. As of September 30, 2011, the Senior Notes had a fair value of approximately \$83.2 million based on a broker quoted price.

Convertible Notes On June 17, 2008, Sotheby's issued \$200 million aggregate principal amount of 3.125% Convertible Notes, due June 15, 2013. The net proceeds from the issuance of the Convertible Notes were approximately \$194.3 million, after deducting transaction costs. Each of Sotheby's existing and future domestic subsidiaries have jointly, severally, fully and unconditionally guaranteed the Convertible Notes on a senior unsecured basis to the extent such subsidiaries guarantee borrowings under the Credit Agreement, as amended. Interest on the Convertible Notes is payable semi-annually in cash on June 15 and December 15 of each year. Sotheby's may not redeem the Convertible Notes prior to their stated maturity date. As of September 30, 2011, the Convertible Notes had a fair value of \$203.5 million based on a broker quoted price.

Upon conversion, the principal amount of the Convertible Notes is payable in cash, shares of Sotheby's Common Stock, or a combination thereof, at the option of Sotheby's, based on an initial conversion rate of 29.4122 shares of Common Stock per \$1,000 principal amount of Convertible Notes, which is equivalent to a conversion price of approximately \$34 per share (the Conversion Price). The maximum number of shares of Common Stock that may be issued upon conversion is approximately 5.3 million shares. The conversion rate for the Convertible Notes is subject to adjustment for certain events.

The Convertible Notes may be converted at any time beginning on March 15, 2013 and ending on the close of business on June 14, 2013. Prior to March 15, 2013, the Convertible Notes may only be converted under certain conditions, including, if during any fiscal quarter (and only during such fiscal quarter), the closing price of Sotheby's Common Stock exceeds \$44.20 per share (i.e., 130% of the Conversion Price) for at least 20 trading days in the period of 30 consecutive trading days at the end of the previous quarter (the Stock Price Trigger). Upon conversion, Sotheby's will pay or deliver, as the case may be, cash, shares of Common Stock, or a combination thereof, at its election. It is Sotheby's current intent and policy to settle up to the principal amount of the Convertible Notes in cash. Additionally, depending on the level of available cash and liquidity, as well as the amount of conversion requests received at any one time, Sotheby's may elect to settle the entire conversion obligation (i.e., principal amount redeemed plus any conversion premium) in cash.

On April 1, 2011, the trustee for the Convertible Notes notified bondholders that the Convertible Notes would be convertible at their option for a period beginning on April 1, 2011 and ending on June 30, 2011 as a result of the closing price of Sotheby's Common Stock exceeding \$44.20 for 20 trading days in the 30 consecutive trading days ending on March 31, 2011.

In June 2011, Sotheby's received conversion requests totaling a principal amount of \$18.1 million from holders of the Convertible Notes. In accordance with the terms of the Convertible Notes, the conversion obligation was based on a formula, which is the sum of 1/30th of the product of the applicable conversion rate and the daily per share volume weighted average stock price for 30 consecutive trading days beginning three days after the conversion request is received from the trustee.

The conversion obligation of \$22.5 million related to these conversion requests, which consisted of \$18.1 million related to principal and approximately \$4.4 million related to the conversion premium, was settled entirely in cash in August 2011. Sotheby's simultaneously received \$4.4 million in cash to fund the conversion premium through its exercise of a portion of the Convertible Note Hedges (see discussion below). In the third quarter of 2011, Sotheby's recognized a \$1.5 million loss representing the write-off of a proportionate amount of unamortized discount and deferred transaction costs related to the Convertible Notes redeemed.

Upon the adoption of Accounting Standards Codification (ASC) 470-20, *Debt - Debt With Conversion and Other Options*, the liability and equity components of the Convertible Notes were separately accounted for in Sotheby's financial statements. The liability component was initially valued at \$161.8 million using Sotheby's nonconvertible debt borrowing rate, which was estimated to be 7.75% at the date of adoption, and was accounted for as Long-Term Debt. The equity component (i.e., the embedded conversion option) was initially valued at \$38.2 million (\$21 million, net of taxes) and was accounted for as a component of Additional Paid-In Capital within Shareholders' Equity. The corresponding debt discount is being amortized to Interest Expense over the life of the Convertible Notes using the effective interest rate method. The amount recorded in Shareholders' Equity is not remeasured as long as it continues to meet the conditions for equity classification.

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As of September 30, 2011, the unamortized discount related to the Convertible Notes was \$13.4 million and the carrying value of the embedded conversion option recorded in Shareholders' Equity was \$30 million (\$15.6 million, net of taxes). As of September 30, 2011, management evaluated the remaining embedded conversion option and concluded that it continued to meet the conditions for equity classification. Accordingly, the carrying value of the remaining embedded conversion option was not remeasured as of September 30, 2011 and remains recorded as a component of Additional Paid-In Capital within Shareholders' Equity.

The Stock Price Trigger was not met during the second or third quarters of 2011. Therefore, as of September 30, 2011, the entire amount of the unamortized Convertible Notes (\$168.4 million) is reflected within Long-Term Debt on Sotheby's balance sheet. The Convertible Notes could be classified within Current Liabilities if the Stock Price Trigger is met again in future fiscal quarters.

Convertible Note Hedges and Warrant Transactions On June 11, 2008, in conjunction with the issuance of the Convertible Notes, Sotheby's entered into convertible note hedge transactions (the Convertible Note Hedges) that allow Sotheby's to purchase its Common Stock from affiliates of Bank of America and Goldman Sachs & Co. (collectively, the Counterparties) at a price equal to the Conversion Price of the Convertible Notes. The Convertible Note Hedges will cover, subject to customary anti-dilution adjustments, approximately 5.3 million shares of Common Stock. The Convertible Note Hedges may be settled in cash, Sotheby's Common Stock, or a combination thereof, and are intended to offset the impact of any conversion premium upon potential future conversions of the Convertible Notes. In the event that Sotheby's elects to settle the conversion premium related to any Convertible Note redemptions in cash, the Convertible Note Hedges allow Sotheby's to recover this amount. In the event that Sotheby's elects to settle the conversion premium related to any Convertible Note redemptions in shares of its Common Stock, the Convertible Note Hedges offset the dilutive impact of any shares issued. The Convertible Note Hedges expire upon the maturity of the Convertible Notes.

As previously discussed, in June 2011, Sotheby's received conversion requests totaling a principal amount of \$18.1 million from holders of the Convertible Notes. As a result, in June 2011, Sotheby's exercised the portion of the Convertible Note Hedges related to these conversion requests, which enabled the Company to receive \$4.4 million, which was an amount equal to the conversion premium paid upon settlement of the Convertible Notes in August 2011.

The Convertible Note Hedges initially met all of the applicable criteria for equity classification and, as a result, in June 2008, the related \$40.6 million cost (\$22.5 million, net of taxes) was recorded on Sotheby's balance sheet as a component of Additional Paid-In Capital within Shareholders' Equity. As of September 30, 2011, the carrying value of the Convertible Note Hedges recorded in Shareholders' Equity was \$32.4 million (\$17.2 million, net of taxes). As of September 30, 2011, management evaluated the remaining Convertible Note Hedges and concluded that they continued to meet the conditions for equity classification. Accordingly, the carrying value of the remaining Convertible Note Hedges were not remeasured as of September 30, 2011 and remains recorded as a component of Additional Paid-In Capital within Shareholders' Equity.

On June 11, 2008, Sotheby's also entered into warrant transactions, whereby it sold to the Counterparties warrants (the Warrants) to acquire, subject to customary anti-dilution adjustments, approximately 5.8 million shares of Common Stock at \$44.905 per share that may only be exercised beginning on the June 15, 2013 maturity date of the Convertible Notes. As of June 11, 2008, the Warrants met all of the applicable criteria for equity classification and, as a result, the \$22.3 million in net proceeds received from the sale of the Warrants was recorded on Sotheby's balance sheet within Additional Paid-In Capital in Shareholders' Equity. As of September 30, 2011, management evaluated the Warrants and concluded that they should not be accounted for separately as a derivative financial instrument because they continue to be indexed to Sotheby's Common Stock. Accordingly, the \$22.3 million in net proceeds received from the sale of the Warrants remains recorded as a component of Additional Paid-In Capital within Shareholders' Equity.

Future Principal and Interest Payments As of September 30, 2011, the aggregate future principal and interest payments due under the York Property Mortgage, the Convertible Notes and the Senior Notes are as follows (in thousands of dollars):

| | |
|---|-------------------|
| October 2011 to September 2012 | \$ 27,885 |
| October 2012 to September 2013 | 209,753 |
| October 2013 to September 2014 | 22,202 |
| October 2014 to September 2015 | 315,897 |
| Total future principal and interest payments | \$ 575,737 |

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Interest Expense For the three and nine months ended September 30, 2011 and 2010, Interest Expense consisted of the following (in thousands of dollars):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Revolving credit facility: | | | | |
| Amortization of amendment and arrangement fees | \$ 430 | \$ 739 | \$ 1,311 | \$ 2,084 |
| Commitment fees | 326 | 511 | 948 | 1,500 |
| Sub-total | 756 | 1,250 | 2,259 | 3,584 |
| York Property Mortgage | 4,238 | 4,280 | 12,639 | 12,724 |
| Senior Notes | 1,586 | 2,538 | 4,755 | 7,611 |
| Convertible Notes | 3,402 | 3,413 | 10,414 | 10,136 |
| Other interest expense | 348 | 359 | 1,210 | 1,121 |
| Total interest expense | \$ 10,330 | \$ 11,840 | \$ 31,277 | \$ 35,176 |

For the three and nine months ended September 30, 2011 and 2010, other interest expense consisted primarily of the amortization of debt issuance costs related to the Senior Notes and Convertible Notes.

For the three and nine months ended September 30, 2011 and 2010, Interest Expense related to the Convertible Notes consisted of the following (in thousands of dollars):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|-------------------------------------|----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Contractual coupon interest expense | \$ 1,492 | \$ 1,562 | \$ 4,617 | \$ 4,687 |
| Discount amortization | 1,910 | 1,851 | 5,797 | 5,449 |
| Total | \$ 3,402 | \$ 3,413 | \$ 10,414 | \$ 10,136 |

7. Defined Benefit Pension Plan

Sotheby's sponsors a defined benefit pension plan covering a portion of its U.K. employees (the U.K. Pension Plan). For the three and nine months ended September 30, 2011 and 2010, the components of the net pension benefit related to the U.K. Pension Plan are (in thousands of dollars):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------------------------------|-------------------------------------|----------|------------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| Service cost | \$ 1,008 | \$ 965 | \$ 3,021 | \$ 2,867 |
| Interest cost | 3,430 | 3,478 | 10,280 | 10,337 |
| Expected return on plan assets | (5,838) | (5,372) | (17,498) | (15,965) |
| Amortization of prior service cost | | 3 | | 9 |
| Net pension benefit | \$ (1,400) | \$ (926) | \$ (4,197) | \$ (2,752) |

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In 2011, Sotheby's expects to contribute approximately \$3 million to the U.K. Pension Plan, of which \$2.2 million has been contributed through September 30, 2011.

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On June 27, 2011, the Executive Committee of Sotheby's Board of Directors approved a restructuring plan (the "Restructuring Plan") impacting Sotheby's operations in Italy and the Netherlands. The Restructuring Plan will streamline Sotheby's European selling operations, with a renewed emphasis on relationships with key clients and the sourcing of important collections. The Restructuring Plan will also allow Sotheby's global management to focus resources on growing markets, especially China, and other strategic priorities. In the Netherlands, the Restructuring Plan will result in the cessation of all local auction sales. In Italy, Sotheby's will significantly reduce its auction sales calendar, but plans to continue to conduct auctions of Contemporary and Modern Art. Sotheby's streamlined European operations will continue to source property to its other selling locations throughout the world, as well as pursue private sale opportunities.

The Restructuring Plan will reduce staff by 24, which represents approximately 46% of Sotheby's current headcount in Italy and the Netherlands and 2% of its global headcount. The Restructuring Plan will also allow Sotheby's to completely exit its leased Amsterdam salesroom, replacing it with a smaller local office, and significantly reduce the cost associated with its Milan premises.

The following table summarizes net Restructuring Charges for the three and nine months ended September 30, 2011 (in thousands of dollars):

| | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2011 |
|-------------------------------|--|---|
| Employee termination benefits | \$ 133 | \$ 1,812 |
| Facility related costs | 2,047 | 2,636 |
| Other costs | 28 | 28 |
| Total | \$ 2,208 | \$ 4,476 |

The facility related charges recognized in the third quarter of 2011 are the result of a lease termination fee incurred in September 2011 related to Sotheby's Amsterdam salesroom, which will be vacated by the end of the year. Accrued restructuring costs of \$4.5 million are recorded within Accounts Payable and Accrued Liabilities in the September 30, 2011 Condensed Consolidated Balance Sheet. Total cash expenditures related to the Restructuring Plan are expected to be approximately \$5 million, substantially all of which are expected to be made in the fourth quarter of 2011.

9. Commitments and Contingencies

Employment Arrangements As of September 30, 2011, Sotheby's had employment arrangements with certain senior employees, which expire at various points between February 2012 and March 2017. Such arrangements may provide, among other benefits, for minimum salary levels and for incentive compensation under Sotheby's incentive compensation programs which is payable only if specified company and individual goals are attained. Additionally, certain of these arrangements provide annual equity grants, the accelerated vesting of certain equity grants, severance payments, other cash compensation, and continuation of benefits upon termination of employment under certain circumstances. The aggregate remaining commitment for salaries and other cash compensation related to these employment arrangements, excluding any participation in Sotheby's incentive compensation and share-based payment programs, was approximately \$22.1 million as of September 30, 2011.

Lending Commitments Sotheby's enters into legally binding arrangements to lend, primarily on a collateralized basis and subject to certain limitations and conditions, to potential consignors and other individuals who have collections of art. Unfunded commitments to extend additional credit were \$17.2 million as of September 30, 2011, of which \$1 million is committed to an employee of Sotheby's who is not an Executive Officer.

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Legal Actions Sotheby's becomes involved in various claims and lawsuits incidental to the ordinary course of its business, including the matter described below. While it is not possible to predict the outcome of litigation, management does not believe that the outcome of any of these pending claims or proceedings will have a material adverse effect on Sotheby's consolidated results of operations, financial condition and/or cash flows.

Estate of Robert Graham, et al. v. Sotheby's, Inc. is a purported class action commenced in the United States District Court for the Central District of California in October 2011 on behalf of U.S. artists (and their estates) whose artworks were sold by Sotheby's in the State of California or at auction by California sellers and for which a royalty was allegedly due under the California Resale Royalties Act (the Resale Royalties Act). Plaintiffs seek unspecified damages, punitive damages and injunctive relief for alleged violations of the Resale Royalties Act and the California Unfair Competition Law. It is currently not possible to make an estimate of the amount or range of loss that could result from an unfavorable outcome of this matter. Sotheby's believes that there are meritorious defenses to the claims asserted by plaintiffs, and they will be vigorously defended.

(See Notes 5, 10 and 13 for information on other contingencies. See Notes 6, 7 and 8 for information on other commitments.)

10. Auction Guarantees

From time to time in the ordinary course of its business, Sotheby's will guarantee to consignors a minimum sale price in connection with the sale of property at auction (an auction guarantee). In the event that the property sells for less than the guaranteed price, Sotheby's must perform under the auction guarantee by funding the difference between the sale price at auction and the amount of the auction guarantee. Sotheby's is generally entitled to a share of the excess proceeds (the overage) if the property under the auction guarantee sells above the guaranteed price. If the property does not sell, the amount of the auction guarantee must be paid, but Sotheby's has the right to recover such amount through the future sale of the property. In these situations, the guaranteed property is recorded as Inventory on Sotheby's balance sheet at the lower of cost (i.e., the amount paid under the auction guarantee) or management's estimate of the property's net realizable value (i.e., expected sale price upon disposition). The sale proceeds ultimately realized by Sotheby's in these situations may equal, exceed or be less than the amount recorded as Inventory on Sotheby's balance sheet.

Sotheby's may reduce its financial exposure under auction guarantees through risk and reward sharing arrangements, which include:

Contractual arrangements under which a counterparty contractually commits to bid a predetermined price for the guaranteed property (an irrevocable bid). If the irrevocable bid is the winning bid, the counterparty purchases the property at the predetermined price plus the applicable buyer's premium, which is the same amount that any other successful bidder would pay at that price. If the irrevocable bid is not the winning bid, the counterparty is generally entitled to receive a share of the auction commission earned on the sale and/or a share of any overage.

Contractual arrangements under which a counterparty contractually commits to fund: (i) a share of the difference between the sale price at auction and the amount of the auction guarantee, if the property sells for less than the guaranteed price, or (ii) a share of the guaranteed price if the property does not sell while taking ownership of a proportionate share of the unsold property. In exchange for accepting a share of the financial exposure under the auction guarantee, if the property sells, the counterparty is entitled to receive a share of the auction commission earned on the sale and/or a share of any overage.

The counterparties to these auction guarantee risk and reward sharing arrangements are typically major international art dealers or major art collectors. Sotheby's could be exposed to losses in the event any of these counterparties do not perform according to the terms of these contractual arrangements.

As of September 30, 2011, Sotheby's had outstanding auction guarantees totaling \$78 million, with most of the individual properties under the outstanding auction guarantees having a presale low estimate approximately equal to the guaranteed price. Sotheby's financial exposure under these auction guarantees is reduced by irrevocable bids from unaffiliated third parties. If the irrevocable bids are the winning bids for the property underlying these auction guarantees, the total proceeds from the irrevocable bidders, including buyer's premium, would be no less than the aggregate amount of these auction guarantees. All of the property related to such auction guarantees is being offered at auctions in the fourth quarter of 2011. As of September 30, 2011, \$10 million of the guaranteed amount had been advanced by Sotheby's and is recorded on the balance sheet within Notes Receivable and Consignor Advances. As of September 30, 2011, December 31, 2010 and September 30, 2010, the carrying amount of the liability representing the estimated fair value of Sotheby's obligation to perform under its auction guarantees was approximately \$0.2 million, \$0.1 million and \$0.2 million, respectively, and is recorded on the balance sheet within Accounts Payable and

Accrued Liabilities.

Table of Contents**11. Comprehensive (Loss) Income**

Sotheby's comprehensive (loss) income includes the net (loss) income for the period, as well as other comprehensive (loss) income which consists almost entirely of the change in the foreign currency translation adjustment account. For the three and nine months ended September 30, 2011 and 2010, comprehensive (loss) income consists of the following (in thousands of dollars):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-------------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Net (loss) income | (\$ 29,719) | \$ (19,361) | \$ 99,936 | \$ 64,701 |
| Other Comprehensive (Loss) Income: | | | | |
| Foreign currency exchange rate (losses) gains | (27,206) | 31,484 | 2,500 | (526) |
| Amortization of prior service cost and actuarial losses related to the U.K. defined benefit pension plan, net of taxes | | 2 | | 6 |
| Total other comprehensive (loss) income | (27,206) | 31,486 | 2,500 | (520) |
| Comprehensive (loss) income | (\$ 56,925) | \$ 12,125 | \$ 102,436 | \$ 64,181 |

12. Share-Based Payments and Dividends

Share-Based Payments Share-based payments to employees include performance-based stock awards, restricted stock, restricted stock units and stock options, as discussed in more detail below. For the three and nine months ended September 30, 2011 and 2010, compensation expense related to share-based payments, which is reflected within Salaries and Related Costs in Sotheby's statements of operations, is summarized as follows (in thousands of dollars):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------|-------------------------------------|----------|------------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Pre-Tax | \$ 3,797 | \$ 5,342 | \$ 14,196 | \$ 15,978 |
| After-Tax | \$ 2,164 | \$ 4,045 | \$ 9,504 | \$ 11,004 |

For the three and nine months ended September 30, 2011 and 2010, compensation expense related to share-based payments decreased \$1.5 million (29%) and \$1.8 million (11%), respectively, when compared to the prior year. These decreases are largely attributable to a reduction to share-based payment expense of \$1.3 million recorded in the third quarter of 2011 as a result of a change in management's assessment of the likelihood and timing of achieving the relevant profitability targets for certain performance-based equity awards. See Performance Share Units below.

For the nine months ended September 30, 2011, Sotheby's realized \$7.2 million of excess tax benefits related to share-based payment arrangements. These excess tax benefits represent the amount by which the tax deduction ultimately received by Sotheby's as a result of the exercise or vesting of share-based payments exceeds the tax benefit initially recognized in the financial statements upon the amortization of compensation expense for these awards. Such excess tax benefits are recognized in Additional Paid-in Capital in Sotheby's balance sheets and are classified within Cash Provided (Used) by Financing Activities in Sotheby's statements of cash flows.

As of September 30, 2011, unrecognized compensation expense related to the unvested portion of share-based payments was approximately \$22.8 million. This compensation expense is expected to be amortized over a weighted-average period of approximately 3.1 years. Sotheby's does not capitalize any compensation expense related to share-based payments to employees.

Sotheby's Restricted Stock Unit Plan The Sotheby's Restricted Stock Unit Plan (the Restricted Stock Unit Plan) provides for the issuance of unvested shares of Common Stock (Restricted Stock) and Restricted Stock Units (RSUs) to employees, subject to the approval of the Compensation Committee of Sotheby's Board of Directors (the Compensation Committee). In making awards under the Restricted Stock Unit Plan, the Compensation Committee takes into account the nature of the services rendered by employees, their present and potential contributions

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to Sotheby's success, and such other factors as the Compensation Committee in its discretion deems relevant.

Restricted Stock and RSU's generally vest evenly over a four year service period. Prior to vesting, holders of Restricted Stock have voting rights and are entitled to receive dividends, while holders of RSU's do not have voting rights, but are entitled to receive dividend equivalents. Dividends and dividend equivalents paid to holders of unvested Restricted Stock and RSU's are not forfeitable. Restricted Stock and RSU's may not be sold, assigned, transferred, pledged or otherwise encumbered until they vest.

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Performance Share Units Performance Share Units (or PSU s) are RSU s issued pursuant to the Restricted Stock Unit Plan which vest ratably, generally over four years, if Sotheby s achieves certain profitability targets. Prior to vesting, holders of PSU s do not have voting rights and are not entitled to receive dividends or dividend equivalents. Dividend equivalents are credited to holders of PSU s and are only paid for the portion of PSU s that vest. PSU s may not be sold, assigned, transferred, pledged or otherwise encumbered until they vest. The Compensation Committee believes that PSU s better align Sotheby s variable compensation strategy with its financial performance and the cyclical nature of the art market and further align the interests of Sotheby s management with its shareholders. Accordingly, Sotheby s intends to grant future equity awards in the form of PSU s with performance and service conditions, rather than RSU s with service conditions only.

Effective September 1, 2010, Sotheby s entered into a new employment agreement with William F. Ruprecht, its President and Chief Executive Officer. This employment agreement is for a four-year term ending on August 31, 2014, with one year renewals thereafter unless Sotheby s or Mr. Ruprecht provides notice of non-renewal at least five months prior to the end of the term or an annual extension. Among other things, Mr. Ruprecht s employment agreement entitles him to annual PSU grants beginning in 2011 subject to minimum (\$3.5 million) and maximum (\$4.5 million) levels, the value of which are determined at the discretion of the Compensation Committee.

Summary of Restricted Stock, RSU s and PSU s For the nine months ended September 30, 2011, changes in the number of outstanding Restricted Stock, RSU s and PSU s were as follows (shares in thousands):

| | Restricted Stock, RSU s and PSU s | Weighted Average Grant Date Fair Value |
|-----------------------------------|--|---|
| Outstanding at January 1, 2011 | 2,370 | \$ 18.86 |
| Granted | 628 | \$ 41.80 |
| Vested | (998) | \$ 23.35 |
| Canceled | (10) | \$ 17.06 |
| Outstanding at September 30, 2011 | 1,990 | \$ 23.89 |

In the first quarter of 2011, Sotheby s issued 627,566 PSU s with a grant date fair value of \$26.2 million as follows: (i) 526,903 PSU s with a fair value of \$22 million related to Sotheby s incentive compensation programs and (ii) 100,663 PSU s with a fair value of \$4.25 million issued to Mr. Ruprecht in relation to his September 2010 employment agreement, as discussed above.

In March 2011, 242,539 PSU s awarded in February 2010 vested as a result of the achievement of the corresponding profitability target for the year ended December 31, 2010. In addition, in March 2011, 120,000 Restricted Stock shares granted to Mr. Ruprecht in April 2006 vested as a result of the achievement of a five-year profitability target.

The aggregate fair value of Restricted Stock, RSU s and PSU s that vested during the nine months ended September 30, 2011 and 2010 was \$45.2 million and \$18.3 million, respectively, based on the closing price of Sotheby s Common Stock on the dates the shares vested.

As of September 30, 2011, 1.6 million shares were available for future awards pursuant to the Restricted Stock Unit Plan.

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Stock Options Stock options issued pursuant to the Sotheby's 1997 Stock Option Plan are exercisable into authorized but unissued shares of Common Stock. Stock options vest evenly over four years and expire ten years after the date of grant. Changes in the number of stock options outstanding for the nine months ended September 30, 2011 were as follows (options and aggregate intrinsic value in thousands):

| | Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|-----------------------------------|---------|------------------------------------|---|------------------------------|
| Outstanding at January 1, 2011 | 512 | \$ 21.82 | | |
| Granted | | \$ | | |
| Exercised | (121) | \$ 21.44 | | |
| Outstanding at September 30, 2011 | 391 | \$ 21.94 | 8.2 | \$ 2,206 |
| Exercisable at September 30, 2011 | 16 | \$ 17.84 | 6.3 | \$ 153 |

The aggregate intrinsic value of options exercised during the nine months ended September 30, 2011 and 2010, was \$3.2 million and \$3.2 million, respectively. Cash received from the exercise of stock options that were exercised during the nine months ended September 30, 2011 was \$2.6 million. Cash received from the exercise of stock options that were exercised during the nine months ended September 30, 2010 totaled \$5.9 million. Sotheby's also received \$4.1 million in cash in January 2010 for stock options that were exercised in late December 2009. For the nine months ended September 30, 2011 and 2010, the excess tax benefits realized from the exercise of stock options totaled \$0.8 million and \$1.2 million, respectively.

Noortman Master Paintings (NMP) On June 7, 2006, Sotheby's entered into a sale and purchase agreement (the Purchase Agreement) with Arcimboldo S.A. (Arcimboldo) pursuant to which Sotheby's acquired all of the issued and outstanding shares of capital stock of NMP. Pursuant to the Purchase Agreement, Sotheby's paid initial consideration (the Initial Consideration) in the form of 1,946,849 shares of Sotheby's Common Stock. Pursuant to the Purchase Agreement, if NMP failed to achieve a minimum level of financial performance during the five years following the closing of the transaction, up to 20% of the Initial Consideration would be transferred back to Sotheby's. The minimum level of financial performance was not achieved and, as a result, 147,352 shares of Sotheby's Common Stock will be transferred back to Sotheby's in the fourth quarter of 2011. For the nine months ended September 30, 2011, Sotheby's recognized a net benefit of \$0.6 million to compensation expense to reflect the final number of shares of Common Stock that will be transferred back to Sotheby's.

Dividends During the three and nine months ended September 30, 2011, Sotheby's paid dividends of \$3.4 million and \$6.9 million, respectively. On November 7, 2011, Sotheby's Board of Directors declared a quarterly dividend of \$0.08 per share (approximately \$5.4 million) to be paid to shareholders of record as of December 1, 2011 on December 15, 2011.

The declaration and payment of future dividends to shareholders is at the discretion of Sotheby's Board of Directors and will depend on many factors, including Sotheby's financial condition, cash flows, legal requirements and other factors as the Board of Directors deems relevant.

13. Income Taxes

Reversal of Deferred Tax Asset Valuation Allowance In 2009, as a result of cumulative three year losses in certain state and local jurisdictions and management's assessment of Sotheby's ability to utilize certain state and local deferred tax assets, including net operating losses against projected income, a valuation allowance was established.

As of the third quarter of 2011, Sotheby's is no longer in a cumulative three year loss position in the state and local jurisdictions in which it had established the valuation allowance against its deferred tax assets. As a result, management assessed whether there was sufficient positive evidence to conclude that it is more likely than not that these deferred tax assets will be realized and that the valuation allowance is no longer required. This sufficient positive evidence included, but was not limited to, recent profitability, management's expectation of future profitability, the expected timing of the reversals of the deferred tax assets and the present economic conditions as compared to the economic conditions when the valuation allowance was established. Based on this assessment, in the third quarter of 2011, management concluded that it is more likely than not that these deferred tax assets will be realized and, as a result, Sotheby's reversed the valuation allowance. The reversal of the valuation allowance resulted in the recognition of an \$11.6 million benefit recorded through the third quarter of 2011, which included a discrete benefit of \$9.6 million recognized in the third quarter of 2011 and an additional benefit of \$2 million being recognized through its annual effective income tax rate. In the fourth quarter of 2011, an additional benefit of \$2 million will be recognized through Sotheby's effective income tax rate.

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Uncertain Tax Positions As of September 30, 2011, Sotheby's liability for unrecognized tax benefits, excluding interest and penalties, was \$31.8 million, representing an increase of \$2.6 million when compared to December 31, 2010. As of September 30, 2010, Sotheby's liability for unrecognized tax benefits was \$43.3 million. As of September 30, 2011 and 2010, the total amount of unrecognized tax benefits that, if recognized, would favorably affect Sotheby's effective tax rate is \$16.8 million and \$24.9 million, respectively.

Sotheby's believes it is reasonably possible that a decrease of \$1.8 million in the balance of unrecognized tax benefits can occur within 12 months of the September 30, 2011 balance sheet date as a result of the expiration of the statute of limitations and expected settlements of currently ongoing tax audits.

Sotheby's is subject to taxation in the U.S. and various state and foreign jurisdictions. Years still open for audit are, for federal purposes, from 2008, and for the following major state and local jurisdictions: New York State from 2007; New York City from 2007; and California from 2005. Sotheby's foreign subsidiaries file income tax returns in the countries in which they have operations. Years still open to examination by foreign tax authorities include Hong Kong from 2005 and the U.K. from 2005.

Sotheby's recognizes interest expense and penalties related to unrecognized tax benefits as a component of Income Tax Expense. Sotheby's accrual for such interest and penalties increased by \$0.4 million for the nine months ended September 30, 2011.

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Sotheby's policy is to record interest expense related to sales, value added and other taxes as Interest Expense in its statements of operations. Penalties related to such taxes are recorded as General and Administrative Expenses in its statements of operations. Interest expense and penalties related to income taxes are recorded as a component of Income Tax Expense in Sotheby's statements of operations.

14. Related Party Transactions

For the three and nine months ended September 30, 2011, Sotheby's recognized aggregate auction commission revenues of \$0.9 million and \$5.9 million, respectively, related to the purchase of property by related parties. These revenues represent approximately 2% and 1% of total revenues for the three and nine months ended September 30, 2011, respectively.

As of September 30, 2011, net Accounts Receivable of \$376 million includes \$4.6 million associated with related party transactions, representing approximately 1% of net Accounts Receivable.

15. Recently Issued Accounting Standards

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009 13, *Multiple-Deliverable Revenue Arrangements*, which is codified in ASC 605, *Revenue Recognition*. This update addresses the unit of accounting for arrangements involving multiple deliverables and how to allocate arrangement consideration to one or more units of accounting. It eliminates the criteria that objective and reliable evidence of the fair value of any undelivered items must exist for the delivered items to be considered separate units of accounting. This update was effective starting in the first quarter of 2011 and did not impact Sotheby's financial statements.

In June 2011, the FASB issued ASU 2011 05, *Presentation of Comprehensive Income*, which is codified in ASC 220, *Comprehensive Income*. This update eliminates the option for entities to present the components of other comprehensive income as part of the statement of changes in shareholder's equity and requires entities to report the components of comprehensive income (i.e., net income and other comprehensive income) in either: (1) a single, continuous statement of comprehensive income or (2) two separate, but consecutive, statements. ASU 2011-05 does not change the items that must be reported in other comprehensive income and does not require incremental disclosures in addition to those already required by ASC 220. This update will be effective for Sotheby's quarterly and annual financial statements beginning in the first quarter of 2012. Management is currently evaluating the adoption alternatives provided by ASU 2011-05.

In September 2011, the FASB issued ASU 2011 08, *Intangibles - Goodwill and Other: Testing Goodwill for Impairment*, which is codified in ASC 350, *Intangibles - Goodwill and Other*. This update gives entities testing goodwill for impairment the option of performing a qualitative assessment before calculating the fair value of a reporting unit in step 1 of the goodwill impairment test. If entities determine, on the basis of qualitative factors, that the fair value of a reporting unit is more likely than not less than the carrying amount, the two-step impairment test would be required. Otherwise, further testing would not be needed. This update will be effective for Sotheby's quarterly and annual financial statements beginning in the first quarter of 2012. Early adoption is permitted. Management is currently evaluating the potential impact of electing to perform the qualitative assessment allowed under ASU 2011-08.

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ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Seasonality

The worldwide art auction market has two principal selling seasons, which generally occur in the second and fourth quarters of the year. Accordingly, Sotheby's auction business is seasonal, with peak revenues and operating income generally occurring in those quarters. Consequently, first and third quarter results have historically reflected a lower volume of auction activity 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.

RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

This discussion should be read in conjunction with Note 4 (Segment Reporting) of Notes to Condensed Consolidated Financial Statements.

Overview

As discussed above, due to the seasonality of the auction business, the third quarter typically reflects a net loss. Accordingly, in the third quarter of 2011, Sotheby's reported a net loss of \$29.7 million which compares unfavorably to a net loss of \$19.4 million in the prior period. The increased net loss is principally due to a 4% decrease in auction commission revenues, as well as a higher level of general and administrative expenses and \$2.2 million of restructuring charges related to Sotheby's plan to streamline its European selling operations. Third quarter results are also unfavorably impacted by \$5.7 million of Dealer segment inventory writedowns related to Noortman Master Paintings.

For the nine months ended September 30, 2011, Sotheby's net income increased \$35.2 million (55%) when compared to the prior year primarily due to higher auction and private sale commission revenues. These results reflect the strength of the global art market in the first half of 2011, with year-to-date Net Auction Sales of \$2.7 billion, a level comparable to the art market's most recent peak years between 2006 and 2008. Importantly, these results were achieved with a significantly lower risk profile, as Sotheby's continued to be highly selective in its use of auction guarantees and has only issued auction guarantees in tandem with risk sharing arrangements that greatly reduce its financial exposure. Also, September year-to-date results are favorably impacted by an \$11.6 million benefit recognized in the third quarter of 2011 due to the reversal of a valuation allowance against certain of Sotheby's deferred tax assets.

Sotheby's results for the year-to-date period reflect a higher level of operating expenses due in part to increased incentive compensation costs, a higher level of direct costs of services consistent with the volume and composition of auction sales in the period and the cost of investments in strategic initiatives. In addition, Sotheby's year-to-date results are unfavorably impacted by \$8.3 million of Dealer segment inventory writedowns related to Noortman Master Paintings and \$4.5 million of restructuring charges related to Sotheby's plan to streamline its European selling operations.

See the discussion below for greater detail on the significant factors impacting Sotheby's results for the three and nine months ended September 30, 2011 and the comparison to the corresponding prior periods.

Outlook

Uncertainty and volatility in the global economic environment may have contributed to the mixed results in certain Sotheby's auctions in the early autumn, as the sales growth achieved in the first half of 2011 has slowed. In addition, there continues to be significant price competition for the highest quality collections. Management is mindful of the current economic and competitive environment and is focused on maximizing auction commission margins and maintaining a rational cost structure, while remaining committed to measured investments in the strategic initiatives that are vital to Sotheby's future. Despite these challenges, Sotheby's continues to build liquidity and financial strength. (See statement on Forward Looking Statements.)

Table of Contents**Results of Operations for the Three and Nine Months Ended September 30, 2011 and 2010**

The following tables provide a summary of Sotheby's results of operations for the three and nine months ended September 30, 2011 and 2010, as well as a comparison between the two periods (in thousands of dollars):

| Three Months Ended September 30, | 2011 | 2010 | Favorable/(Unfavorable) | |
|--|----------------|----------------|-------------------------|----------------|
| | | | \$ Change | % Change |
| Revenues: | | | | |
| Auction and related revenues | \$ 52,916 | \$ 55,104 | \$ (2,188) | (4.0%) |
| Finance revenues | 2,923 | 1,932 | 991 | 51.3% |
| Dealer revenues | 591 | 14,991 | (14,400) | (96.1%) |
| License fee revenues | 1,408 | 941 | 467 | 49.6% |
| Other revenues | 372 | 92 | 280 | * |
| Total revenues | 58,210 | 73,060 | (14,850) | (20.3%) |
| Expenses | 103,695 | 102,207 | (1,488) | (1.5%) |
| Operating loss | (45,485) | (29,147) | (16,338) | (56.1%) |
| Net interest expense | (9,800) | (11,451) | 1,651 | 14.4% |
| Extinguishment of debt, net | (1,529) | | (1,529) | N/A |
| Other (expense) income | (1,086) | 2,116 | (3,202) | * |
| Loss before taxes | (57,900) | (38,482) | (19,418) | (50.5%) |
| Equity in (losses) earnings of investees, net of taxes | (25) | 173 | (198) | * |
| Income tax benefit | (28,206) | (18,948) | 9,258 | 48.9% |
| Net loss | \$ (29,719) | \$ (19,361) | \$ (10,358) | (53.5%) |
| Key performance indicators: | | | | |
| Aggregate Auction Sales (a) | \$ 247,907 | \$ 256,232 | \$ (8,325) | (3.2%) |
| Net Auction Sales (b) | \$ 207,760 | \$ 215,887 | \$ (8,127) | (3.8%) |
| Private Sales (c) | \$ 84,329 | \$ 122,906 | \$ (38,577) | (31.4%) |
| Consolidated Sales (d) | \$ 332,827 | \$ 394,129 | \$ (61,302) | (15.6%) |
| Auction Commission Margin (e) | 19.7% | 20.2% | N/A | (2.4%) |
| Direct Costs as a percentage of Net Auction Sales | 2.4% | 2.1% | N/A | (16.2%) |
| Average loan portfolio (f) | \$ 195,160 | \$ 148,981 | \$ 46,179 | 31.0% |
| Nine Months Ended September 30, | | | | |
| | 2011 | 2010 | Favorable/(Unfavorable) | |
| | | | \$ Change | % Change |
| Revenues: | | | | |
| Auction and related revenues | \$ 516,841 | \$ 420,532 | \$ 96,309 | 22.9% |
| Finance revenues | 9,022 | 6,568 | 2,454 | 37.4% |
| Dealer revenues | 16,848 | 25,848 | (9,000) | (34.8%) |
| License fee revenues | 4,119 | 2,775 | 1,344 | 48.4% |
| Other revenues | 757 | 626 | 131 | 20.9% |
| Total revenues | 547,587 | 456,349 | 91,238 | 20.0% |
| Expenses | 393,454 | 337,876 | (55,578) | (16.4%) |
| Operating income | 154,133 | 118,473 | 35,660 | 30.1% |
| Net interest expense | (27,610) | (34,049) | 6,439 | 18.9% |
| Extinguishment of debt, net | (1,529) | | (1,529) | * |
| Other (expense) income | (1,455) | 1,244 | (2,699) | * |

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| | | | | |
|---|--------------|--------------|------------|---------|
| Income before taxes | 123,539 | 85,668 | 37,871 | 44.2% |
| Equity in earnings of investees, net of taxes | 28 | 417 | (389) | (93.3%) |
| Income tax expense | 23,631 | 21,384 | (2,247) | (10.5%) |
| Net income | \$ 99,936 | \$ 64,701 | \$ 35,235 | 54.5% |
| Key performance indicators: | | | | |
| Aggregate Auction Sales (a) | \$ 3,211,745 | \$ 2,410,416 | \$ 801,329 | 33.2% |
| Net Auction Sales (b) | \$ 2,731,410 | \$ 2,050,446 | \$ 680,964 | 33.2% |
| Private Sales (c) | \$ 532,743 | \$ 332,798 | \$ 199,945 | 60.1% |
| Consolidated Sales (d) | \$ 3,761,336 | \$ 2,769,062 | \$ 992,274 | 35.8% |
| Auction Commission Margin (e) | 16.6% | 18.5% | N/A | (10.1%) |
| Direct Costs as a percentage of Net Auction Sales | 1.5% | 1.6% | N/A | 7.1% |
| Average loan portfolio (f) | \$ 217,435 | \$ 166,072 | \$ 51,363 | 30.9% |

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- * Represents a change in excess of 100%.
- (a) Represents the hammer (sale) price of property sold at auction plus buyer's premium.
- (b) Represents the hammer (sale) price of property sold at auction.
- (c) Represents the total purchase price of property sold in private sales brokered by Sotheby's.
- (d) Represents the sum of Aggregate Auction Sales, Private Sales and Dealer revenues.
- (e) Represents total auction commission revenues as a percentage of Net Auction Sales.
- (f) Represents the average loan portfolio of Sotheby's Finance segment.

Revenues

For the three and nine months ended September 30, 2011 and 2010, revenues consisted of the following (in thousands of dollars):

| Three Months Ended September 30, | 2011 | 2010 | Favorable/(Unfavorable) | |
|---|------------------|------------------|-------------------------|----------------|
| | | | \$ Change | % Change |
| Auction and related revenues: | | | | |
| Auction commission revenues | \$ 40,962 | \$ 43,620 | \$ (2,658) | (6.1%) |
| Private sale commissions | 9,750 | 10,106 | (356) | (3.5%) |
| Principal activities | (1,213) | (1,908) | 695 | 36.4% |
| Other auction and related revenues** | 3,417 | 3,286 | 131 | 4.0% |
| Total auction and related revenues | 52,916 | 55,104 | (2,188) | (4.0%) |
| Other revenues: | | | | |
| Finance revenues | 2,923 | 1,932 | 991 | 51.3% |
| Dealer revenues | 591 | 14,991 | (14,400) | (96.1%) |
| License fee revenues | 1,408 | 941 | 467 | 49.6% |
| Other | 372 | 92 | 280 | * |
| Total other revenues | 5,294 | 17,956 | (12,662) | (70.5%) |
| Total revenues | \$ 58,210 | \$ 73,060 | \$ (14,850) | (20.3%) |

| Nine Months Ended September 30, | 2011 | 2010 | Favorable/(Unfavorable) | |
|---|----------------|----------------|-------------------------|--------------|
| | | | \$ Change | % Change |
| Auction and related revenues: | | | | |
| Auction commission revenues | \$ 454,485 | \$ 379,779 | \$ 74,706 | 19.7% |
| Private sale commissions | 47,947 | 29,462 | 18,485 | 62.7% |
| Principal activities | 148 | (3,084) | 3,232 | * |
| Other auction and related revenues** | 14,261 | 14,375 | (114) | (0.8%) |
| Total auction and related revenues | 516,841 | 420,532 | 96,309 | 22.9% |
| Other revenues: | | | | |
| Finance revenues | 9,022 | 6,568 | 2,454 | 37.4% |
| Dealer revenues | 16,848 | 25,848 | (9,000) | (34.8%) |
| License fee revenues | 4,119 | 2,775 | 1,344 | 48.4% |
| Other | 757 | 626 | 131 | 20.9% |

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|----------------------|------------|------------|-----------|---------|
| Total other revenues | 30,746 | 35,817 | (5,071) | (14.2%) |
| Total revenues | \$ 547,587 | \$ 456,349 | \$ 91,238 | 20.0% |

* Represents a change in excess of 100%.

** Principally includes auction expense recoveries and catalogue subscription revenues.

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Auction and Related Revenues

For the three months ended September 30, 2011, auction and related revenues decreased \$2.2 million (4%) when compared to the prior year due to a lower level of auction commission revenues. For the nine months ended September 30, 2011, auction and related revenues increased \$96.3 million (23%) when compared to the prior year almost entirely due to a higher level of auction and private sale commission revenues. The comparison to the prior periods is favorably impacted by changes in foreign currency exchange rates, which increased auction and related revenues by \$1.8 million and \$21.7 million, respectively, during the three and nine month periods. See the discussion below for a more detailed explanation of the factors contributing to the changes in auction and related revenues between the periods.

Auction Commission Revenues In its role as auctioneer, Sotheby's represents sellers of artworks by accepting property on consignment and by matching sellers to buyers through the auction process. Sotheby's invoices the buyer for the purchase price of the property (including the commission owed by the buyer), collects payment from the buyer and remits to the seller the net sale proceeds after deducting its commissions, expenses and applicable taxes and royalties. Sotheby's commissions include those paid by the buyer (buyer's premium) and those paid by the seller (seller's commission) (collectively, auction commission revenue), both of which are calculated as a percentage of Net Auction Sales.

For the three months ended September 30, 2011, auction commission revenues decreased \$2.7 million (6%) due to a 4% reduction in Net Auction Sales, as well as a decrease in Auction Commission Margin from 20.2% to 19.7%. For the nine months ended September 30, 2011, auction commission revenues increased \$74.7 million (20%) due to a 33% improvement in Net Auction Sales partially offset by a decline in Auction Commission Margin from 18.5% to 16.6%. The comparison to the prior periods is also favorably impacted by changes in foreign currency exchange rates, which increased auction commission revenues by \$1.3 million and \$19.6 million, respectively, during the three and nine month periods. See *Net Auction Sales* and *Auction Commission Margin* below for a more detailed discussion of these key performance indicators.

Net Auction Sales For the three months ended September 30, 2011, Net Auction Sales decreased \$8.1 million (4%) when compared to the prior year. This decrease is primarily due to a \$13.8 million decrease in single-owner sales as well as a \$9 million decrease in the recurring various-owner Prints sale in London, which in 2010 included the sale of a special collection of Picasso prints. These decreases are partially offset by an \$8.1 million improvement in recurring various-owner sales of Asian Art in New York and the favorable impact of changes in foreign currency exchange rates, which increased Net Auction Sales by \$7.4 million.

For the nine months ended September 30, 2011, Net Auction Sales increased \$681 million (33%) when compared to the prior year. This increase reflects the strength of the global art market in the first half of 2011, which was supported, in part, by a surge in the activity of buyers and sellers from emerging markets, especially China. The increase in Net Auction Sales was also driven by a number of significant single-owner sales occurring in the first half of 2011. More specifically, the increase in year-to-date Net Auction Sales is attributable to the following factors:

An increase of \$349.4 million (180%) in worldwide sales of Asian Art primarily due to several unprecedented second quarter sales of single-owner collections conducted in Hong Kong, including The Meiyintang Collection of Chinese Porcelain (\$76.6 million), The Mei Yun Tang Collection of Paintings by Chang Dai-chien (\$76.4 million) and The Ullens Collection of Contemporary Chinese Art (\$46.6 million). Recurring various-owner sales of Asian Art also performed well, with a year-to-date increase of \$134.4 million (79%).

An increase of \$42.1 million in sales of Impressionist Art and Contemporary Art.

An increase of \$102 million in single-owner sales in other collecting categories, including the sales of the Evill/Frost Collection of 20th Century British Art (\$54.2 million) and The Stuart Cary Welch Collection of Arts of the Islamic World and Arts of India (\$38 million).

The favorable impact of changes in foreign currency exchange rates, which increased Net Auction Sales by \$110.9 million.

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Auction Commission Margin Auction Commission Margin represents total auction commission revenues as a percentage of Net Auction Sales. Typically, the Auction Commission Margin is higher for lower value works of art or collections, while higher valued property earns a lower Auction Commission Margin. For example, in salesrooms in the U.S., the buyer's premium rate structure is 25% on the first \$50,000 of hammer (sale) price; 20% on the portion of hammer price above \$50,000 up to and including \$1 million; and 12% on any remaining amount above \$1 million.

In certain situations, Auction Commission Margin is adversely impacted by arrangements whereby Sotheby's buyer's premium is shared with a consignor. In such situations, Sotheby's may share its buyer's premium with a consignor in order to secure a high value consignment without issuing an auction guarantee.

Auction Commission Margin may also be adversely impacted by the use of auction guarantees. For example, when issuing an auction guarantee, Sotheby's may enter into a risk and reward sharing arrangement with a counterparty whereby Sotheby's financial exposure under the auction guarantee is reduced in exchange for sharing its auction commission. Also, in situations when the guaranteed property sells for less than the guaranteed price, all or a portion of Sotheby's auction commissions are used to reduce the principal loss on the transaction. (See Note 10 of Notes to Condensed Consolidated Financial Statements for additional information on Sotheby's use of auction guarantees.)

For the three and nine months ended September 30, 2011, Auction Commission Margin was 19.7% and 16.6%, respectively, compared to 20.2% and 18.5% in the same periods of the prior year. The decreases in Auction Commission Margin are attributable to continued competitive pressures to win high value consignments, which resulted in a lower level of seller's commission revenue during the year-to-date period and a higher level of auction commissions shared with consignors.

Private Sale Commissions

For the nine months ended September 30, 2011, private sale commissions increased \$18.5 million (63%) when compared to the prior year. This increase is attributable to a significantly higher volume of high value property sold privately, primarily in the second quarter of 2011, and reflects Sotheby's continued strategic focus on private selling activities.

Principal Activities

Auction segment principal activities consist of gains and losses related to auction guarantees including: (i) any share of overage or shortfall recognized when the guaranteed property is offered or sold at auction, (ii) any subsequent writedowns to the carrying value of guaranteed property that initially failed to sell at auction and (iii) any subsequent recoveries and losses on the sale of guaranteed property that initially failed to sell at auction. Auction segment principal activities also include gains and losses related to the sale of other Auction segment inventory, as well as any writedowns to the carrying value of such inventory, which consists mainly of objects obtained incidental to the auction process primarily as a result of defaults by purchasers after a consignor has been paid.

For the nine months ended September 30, 2011 principal activities improved \$3.2 million when compared to the prior period primarily due to the sale of previously guaranteed property and overage earned from the sale of guaranteed property offered at auction in the first half of 2011, as well as a lower level of writedowns on auction segment inventory.

Finance Revenues

For the three and nine months ended September 30, 2011, Finance revenues increased \$1 million (51%) and \$2.5 million (37%), respectively, when compared to the prior periods due to a higher average balance of interest-bearing loans and higher average interest rates earned in the current periods. For the three and nine months ended September 30, 2011, Finance revenues included \$0.7 million and \$2.2 million, respectively, related to interest earned on a significant loan issued in the fourth quarter of 2010, for which there was no comparable loan outstanding in the prior periods.

(Note: For the purposes of Management's Discussion and Analysis, Finance revenues are presented on a consolidated basis and do not include intercompany revenues earned by the Finance segment from Sotheby's Auction segment, which are eliminated in consolidation. See Note 4 of Notes to Condensed Consolidated Financial Statements.)

Table of Contents**Dealer Revenues and Cost of Sales**

Dealer revenues consist of revenues earned from the sale of Dealer inventory, which includes property owned by Noortman Master Paintings (NMP) and artworks purchased for investment purposes. To a lesser extent, Dealer revenues also include commissions earned by NMP through the brokering of private art sales. Dealer cost of sales includes the net book value of Dealer inventory sold during the period and any writedowns to the carrying value of Dealer inventory.

The table below summarizes Dealer revenues, cost of sales and gross profit for the three and nine months ended September 30, 2011 and 2010 (in thousands of dollars):

| | \$(14,400) | \$(14,400) | \$(14,400) | \$(14,400) |
|---|-------------------|-------------|--------------------------------|-----------------|
| | | | Favorable/(Unfavorable) | |
| Three Months Ended September 30, | 2011 | 2010 | \$ Change | % Change |
| Dealer revenues | \$ 591 | \$ 14,991 | \$ (14,400) | (96.1%) |
| Dealer cost of sales | (6,012) | (14,990) | 8,978 | 59.9% |
| Dealer gross (loss) profit | \$ (5,421) | \$ 1 | \$ (5,422) | * |

| | \$(14,400) | \$(14,400) | \$(14,400) | \$(14,400) |
|--|-------------------|-----------------|--------------------------------|-----------------|
| | | | Favorable/(Unfavorable) | |
| Nine Months Ended September 30, | 2011 | 2010 | \$ Change | % Change |
| Dealer revenues | \$ 16,848 | \$ 25,848 | \$ (9,000) | (34.8%) |
| Dealer cost of sales | (20,267) | (23,305) | 3,038 | 13.0% |
| Dealer gross (loss) profit | \$ (3,419) | \$ 2,543 | \$ (5,962) | * |

* Represents a change in excess of 100%.

In the third quarter of 2011, following the fifth anniversary of the acquisition of NMP and the expiration of the related financial performance targets (see Note 12 of Notes to Condensed Consolidated Financial Statements), management initiated a plan to restructure NMP's business and sales strategy. Historically, NMP has principally specialized in sales of Dutch and Flemish Old Master Paintings, as well as French Impressionist and Post-Impressionist paintings, with a large number of paintings held in inventory at various price points. However, in the future, NMP will greatly reduce its inventory of lower valued Old Master Paintings and shift its focus to a select group of high-valued works of art. Accordingly, NMP will offer a large collection of lower valued works at various auction houses in the fourth quarter of 2011. In the ordinary course of NMP's business, these objects would have been held for a longer period and sold in privately negotiated transactions. As a result of the new strategy described above and due in part to a general weakening of the private dealer market for certain categories of lower valued Old Master Paintings, as well as a shift in the collecting tastes of NMP's clients, inventory writedowns of \$5.7 million were recorded in the third quarter of 2011. For the nine months ended September 30, 2011, Dealer segment inventory writedowns totaled \$8.3 million.

Also impacting Dealer segment results for the current periods are significantly lower NMP revenues principally attributable to the weakening of the private dealer market for certain categories of lower valued Old Master Paintings, as well as a shift in the collecting tastes of NMP's clients.

Table of Contents**Expenses**

For the three and nine months ended September 30, 2011 and 2010, expenses consisted of the following (in thousands of dollars):

| Three Months Ended September 30, | 2011 | 2010 | Favorable / (Unfavorable) \$ Change | % Change |
|---------------------------------------|-------------------|-------------------|--|---------------|
| Direct costs of services | \$ 5,083 | \$ 4,548 | \$ (535) | (11.8%) |
| Dealer cost of sales | 6,012 | 14,990 | 8,978 | 59.9% |
| Marketing expenses | 2,803 | 2,520 | (283) | (11.2%) |
| Salaries and related costs | 45,724 | 46,722 | 998 | 2.1% |
| General and administrative expenses | 37,404 | 29,723 | (7,681) | (25.8%) |
| Depreciation and amortization expense | 4,461 | 3,852 | (609) | (15.8%) |
| Restructuring charges, net | 2,208 | (148) | (2,356) | * |
| Total expenses | \$ 103,695 | \$ 102,207 | \$ (1,488) | (1.5%) |

| Nine Months Ended September 30, | 2011 | 2010 | Favorable / (Unfavorable) \$ Change | % Change |
|---------------------------------------|-------------------|-------------------|--|----------------|
| Direct costs of services | \$ 40,295 | \$ 32,578 | \$ (7,717) | (23.7%) |
| Dealer cost of sales | 20,267 | 23,305 | 3,038 | 13.0% |
| Marketing expenses | 10,639 | 8,736 | (1,903) | (21.8%) |
| Salaries and related costs | 194,186 | 167,661 | (26,525) | (15.8%) |
| General and administrative expenses | 110,788 | 93,342 | (17,446) | (18.7%) |
| Depreciation and amortization expense | 12,803 | 12,304 | (499) | (4.1%) |
| Restructuring charges, net | 4,476 | (50) | (4,526) | * |
| Total expenses | \$ 393,454 | \$ 337,876 | \$ (55,578) | (16.4%) |

* Represents a change in excess of 100%.

Direct Costs of Services

Direct costs of services consists largely of sale specific marketing costs such as auction catalogue production and distribution expenses, sale advertising and promotion expenses, and traveling exhibition costs. Also included in direct costs of services are sale-related shipping expenses. The level of direct costs incurred in any period is generally dependent upon the volume and composition of Sotheby's auction offerings. For example, direct costs attributable to single-owner or other high-value collections are typically higher than those associated with standard various-owner sales, mainly due to higher promotional costs for catalogues, special events and traveling exhibitions, as well as higher shipping expenses.

For the three months ended September 30, 2011, direct costs of services increased \$0.5 million (12%) when compared to the prior year primarily due to higher costs to promote and execute private sales during the period.

For the nine months ended September 30, 2011, direct costs of services increased \$7.7 million (24%) when compared to the prior year. This increase is consistent with the level and composition of Sotheby's auction and private sale offerings in the current period. In particular, the costs to promote single-owner sales increased \$4 million. Additionally, direct costs of services for the year-to-date period include fees associated with the increased usage of debit and credit cards by buyers from China. Direct costs of services for the nine months ended September 30, 2011 were also unfavorably impacted by changes in foreign currency exchange rates, which contributed \$1.6 million to the increase over the prior year.

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The overall increase in direct costs of services for the nine months ended September 30, 2011 is partially offset by an unexpected recovery of \$0.9 million recognized in the second quarter of 2011 related to a property damage loss initially recognized in the first quarter of 2010.

Marketing Expenses

Marketing expenses are costs related to the promotion of the Sotheby's brand and consist of costs related to Sotheby's corporate marketing activities, client service initiatives and strategic sponsorships of cultural institutions. For the three and nine months ended September 30, 2011, marketing expenses increased by \$0.3 million (11%) and \$1.9 million (22%), respectively, due to increased sponsorships of museums and other cultural institutions, as well as a higher level of costs incurred to support certain strategic initiatives, including brand promotion activities in China and other emerging markets and the enhancement of the sothebys.com website.

Table of Contents**Salaries and Related Expenses**

For the three and nine months ended September 30, 2011 and 2010, salaries and related costs consisted of the following (in thousands of dollars):

| Three Months Ended September 30, | \$000,000 | \$000,000 | \$000,000 | \$000,000 |
|---|------------------|------------------|--|-------------|
| | 2011 | 2010 | Favorable / (Unfavorable) \$ Change | % Change |
| Full-time salaries | \$ 31,700 | \$ 27,994 | (\$ 3,706) | (13.2%) |
| Payroll taxes | 3,500 | 3,039 | (461) | (15.2%) |
| Employee benefits | 649 | 5,160 | 4,511 | 87.4% |
| Incentive compensation expense | 2,316 | 2,241 | (75) | (3.3%) |
| Share-based payments | 3,797 | 5,342 | 1,545 | 28.9% |
| Other * | 3,762 | 2,946 | (816) | (27.7%) |
| Total salaries and related costs | \$ 45,724 | \$ 46,722 | \$ 998 | 2.1% |

| Nine Months Ended September 30, | \$000,000 | \$000,000 | \$000,000 | \$000,000 |
|---|-------------------|-------------------|--|----------------|
| | 2011 | 2010 | Favorable / (Unfavorable) \$ Change | % Change |
| Full-time salaries | \$ 95,697 | \$ 83,744 | (\$ 11,953) | (14.3%) |
| Payroll taxes | 16,126 | 12,792 | (3,334) | (26.1%) |
| Employee benefits | 9,773 | 11,850 | 2,077 | 17.5% |
| Incentive compensation expense | 45,953 | 33,265 | (12,688) | (38.1%) |
| Share-based payments | 14,196 | 15,978 | 1,782 | 11.2% |
| Other * | 12,441 | 10,032 | (2,409) | (24.0%) |
| Total salaries and related costs | \$ 194,186 | \$ 167,661 | (\$ 26,525) | (15.8%) |

* Principally includes expense related to the cost of temporary labor and overtime, and certain employment arrangements.

For the three months ended September 30, 2011, salaries and related costs remained relatively consistent with the prior year, with the impact of higher full time salaries and unfavorable movements in foreign exchange rates offset by a decrease in employee benefits costs. For the nine months ended September 30, 2011, salaries and related costs increased \$26.5 million (16%) when compared to the prior year primarily due to higher incentive compensation costs and full-time salaries, as well as the unfavorable impact of changes in foreign currency exchange rates. See below for a detailed discussion of the significant factors contributing to the increases in salaries and related costs.

Full-Time Salaries For the three and nine months ended September 30, 2011, full-time salaries increased \$3.7 million (13%) and \$12 million (14%), respectively, due to strategic headcount and salary increases and the unfavorable impact of changes in foreign currency exchange rates, which contributed \$1 million and \$3 million to the quarter and year-to-date increases, respectively.

Incentive Compensation Expense The amount of incentive compensation expense recorded in a period is largely dependent upon the level of Sotheby's earnings, as measured by EBITDA, and is ultimately paid at the discretion of the Compensation Committee of the Board of Directors only after assessing Sotheby's full year financial results. In addition, incentive compensation includes amounts specifically awarded to employees for the brokering of certain eligible private sale transactions. The increase in incentive compensation expense for the nine months ended September 30, 2011 is due to the improvement in Sotheby's year-to-date earnings, and, to a lesser extent, the significant increase in private sale commissions.

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Payroll Taxes For the three and nine months ended September 30, 2011, payroll taxes increased \$0.5 million (15%) and \$3.3 million (26%), respectively, primarily due to the impact of higher incentive compensation expense and full-time salaries, as discussed above, as well as a higher value of share-based payment awards vesting during the first quarter of 2011.

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Employee Benefits Employee benefits include the cost of Sotheby's retirement plans and health and welfare programs, as well as non-restructuring related employee severance costs. Sotheby's material retirement plans include defined benefit and defined contribution pension plans for employees in the U.K. and defined contribution and deferred compensation plans for U.S. employees.

Generally, the amount of employee benefit costs is dependent upon headcount and overall compensation levels, as well as Sotheby's financial performance. Additionally, the level of expense related to Sotheby's defined benefit pension plan in the U.K. (the "U.K. Pension Plan") is significantly influenced by interest rates, investment performance in the debt and equity markets and actuarial assumptions. Also, the expense recorded for Sotheby's Deferred Compensation Plan (the "DCP") is dependent upon changes in the fair value of the DCP liability during a period, which result from gains and losses in deemed participant investments. Gains in deemed participant investments increase the DCP liability and, therefore, increase employee benefit costs. Losses in deemed participant investments decrease the DCP liability and, therefore, decrease employee benefit costs.

For the three and nine months ended September 30, 2011, employee benefit costs decreased \$4.5 million (87%) and \$2.1 million (18%), respectively. These decreases are largely the result of significantly unfavorable performance of deemed participant investments associated with the DCP, which reduced employee benefits costs by \$4.6 million and \$3.1 million, respectively, in the current quarter and year-to-date periods. On a consolidated basis, the impact of the cost reductions related to the DCP liability are largely offset by significantly unfavorable performance of the trust assets related to the DCP liability, which is reflected within other income (expense).

Also contributing to the decrease in employee benefit costs for the three and nine months ended September 30, 2011 are increases of \$0.5 million and \$1.4 million, respectively, in the net pension credit related to the U.K. Pension Plan. These decreases are attributable to differences in the market-based assumptions used to determine the net pension credit between the periods.

The decreases in employee benefits for the three and nine months ended September 30, 2011 are partially offset by the impact of the increases in full-time salaries and incentive compensation expense discussed above.

Other Compensation Other compensation typically includes expense related to the cost of temporary labor and overtime, as well as expense related to certain employment arrangements. For the three and nine months ended September 30, 2011, other compensation expense increased \$0.8 million (28%) and \$2.4 million (24%), respectively, almost entirely due to higher temporary labor costs in London and New York. The higher temporary labor costs in New York are primarily attributable to temporary labor hired as a result of the lockout of unionized property handlers in the third quarter of 2011, though these costs are partially offset by savings in full-time salaries, employee benefits and payroll taxes. (See Part II, Item 1A, "Risk Factors," for more detailed information on Sotheby's lockout of its unionized property handlers.)

Share-Based Payments Share-based payments consist of the amortization expense for awards of performance-based equity compensation, restricted stock, restricted stock units and stock options. Such equity-based awards are typically granted annually each February and the value of the awards is generally dependent upon Sotheby's financial results for the year prior to the grant date. The amount of expense recognized for share-based payments is based on management's estimates of the number of shares ultimately expected to vest. For performance-based equity compensation, the amount and timing of expense recognition is also significantly impacted by management's assessment of the likelihood and timing of achieving certain profitability targets. (See Note 11 of Notes to Condensed Consolidated Financial Statements for more detailed information on Sotheby's share-based compensation programs.)

For the three and nine months ended September 30, 2011 and 2010, share-based payments expense decreased \$1.5 million (29%) and \$1.8 million (11%), respectively, when compared to the prior year. These decreases are largely attributable to a reduction to share-based payment expense of \$1.3 million recorded in the third quarter of 2011 as a result of a change in management's assessment of the likelihood and timing of achieving the relevant profitability targets for certain performance-based equity awards.

General and Administrative Expenses

For the three and nine months ended September 30, 2011, general and administrative expenses increased \$7.7 million (26%) and \$17.4 million (19%), respectively, when compared to the prior year. These increases are primarily attributable to the following factors:

Increases of \$2.7 million and \$6.7 million, respectively, in professional fees, primarily attributable to a higher level of consulting fees in support of Sotheby's strategic initiatives, including the development of Sotheby's presence in emerging markets such as China and the enhancement of Sotheby's website.

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Increases of \$1.1 million and \$2.9 million, respectively, in travel and entertainment expenses in response to consignment opportunities during the period.

Increases of \$1.1 million and \$2.7 million, respectively, in litigation claims and client goodwill gestures.

Increases of \$0.4 million and \$1.1 million, respectively, in facilities-related expenses.

Increases of \$1 million and \$3 million, respectively, due to unfavorable changes in foreign currency exchange rates.

Table of Contents**Restructuring Charges, Net**

On June 27, 2011, the Executive Committee of Sotheby's Board of Directors approved a restructuring plan (the "Restructuring Plan") impacting Sotheby's operations in Italy and the Netherlands. The Restructuring Plan will streamline Sotheby's European selling operations, with a renewed emphasis on relationships with key clients and the sourcing of important collections. The Restructuring Plan will also allow Sotheby's global management to focus resources on growing markets, especially China, and other strategic priorities. In the Netherlands, the Restructuring Plan will result in the cessation of all local auction sales. In Italy, Sotheby's will significantly reduce its auction sales calendar, but plans to continue to conduct auctions of Contemporary and Modern Art. Sotheby's streamlined European operations will continue to source property to its other selling locations throughout the world, as well as pursue private sale opportunities.

The Restructuring Plan will reduce staff by 24, which represents approximately 46% of Sotheby's current headcount in Italy and the Netherlands and 2% of its global headcount. The Restructuring Plan will also allow Sotheby's to completely exit its leased Amsterdam salesroom, replacing it with a smaller local office, and significantly reduce the cost associated with its Milan premises.

The following table summarizes Restructuring Charges for the three and nine months ended September 30, 2011 (in thousands of dollars):

| | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2011 |
|-------------------------------|--|---|
| Employee termination benefits | \$ 133 | \$ 1,812 |
| Facility related costs | 2,047 | 2,636 |
| Other costs | 28 | 28 |
| Total | \$ 2,208 | \$ 4,476 |

The facility related charges recognized in the third quarter of 2011 are the result of a lease termination fee incurred in September 2011 related to Sotheby's Amsterdam salesroom, which will be vacated by the end of the year. Accrued restructuring costs of \$4.5 million are recorded within Accounts Payable and Accrued Liabilities in the September 30, 2011 Condensed Consolidated Balance Sheet. Total cash expenditures related to the Restructuring Plan are expected to be approximately \$5 million, substantially all of which are expected to be made in the fourth quarter of 2011.

Following its implementation, beginning in 2012, the Restructuring Plan is expected to result in reductions to Net Auction Sales, Revenues and Expenses of approximately \$50 million, \$10 million and \$7 million, respectively, when compared to 2010. Accordingly, the Restructuring Plan is not expected to result in incremental profitability in 2012 as compared to 2010 and in fact, these actions would have had a dilutive impact of approximately \$3 million on 2010 pre-tax income. However, 2010 results for the Netherlands included Net Auction Sales and Revenues of \$19 million and \$3 million, respectively, related to unique sales of single-owner collections not likely to be repeated in the near term. Accordingly, excluding restructuring charges, these actions are not expected to have a dilutive impact on Sotheby's future results.

(See statement on Forward Looking Statements.)

Net Interest Expense

For the three months ended September 30, 2011, net interest expense decreased \$1.7 million (14%). This decrease is primarily due to a \$1 million reduction in interest expense resulting from Sotheby's repurchase of \$48.3 million of its 7.75% Senior Notes in the fourth quarter of 2010. To a lesser extent, the decrease in third quarter net interest expense is also due to lower amortization of credit facility related fees. For the nine months ended September 30, 2011, net interest expense decreased \$6.4 million (19%), primarily due to a year-to-date \$2.9 million reduction in interest expense related to the Senior Notes, \$2.2 million of interest income recognized in the first quarter of 2011 as a result of the resolution of a legal matter related to a delinquent client account and lower amortization of credit facility related fees. The repurchase of Sotheby's 7.75% Senior Notes in the fourth quarter of 2010 will reduce annual interest expense by approximately \$3.7 million in each of the years in the periods 2011 to 2014 and approximately \$1.8 million in 2015. (See statement on Forward Looking Statements.)

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Extinguishment of Debt, Net

On April 1, 2011, the trustee for Sotheby's 3.125% Convertible Notes (the "Convertible Notes") notified bondholders that the Convertible Notes would be convertible at their option for a period beginning on April 1, 2011 and ending on September 30, 2011 as a result of the closing price of Sotheby's Common Stock exceeding \$44.20 for 20 trading days in the 30 consecutive trading days ending on March 31, 2011.

In June 2011, Sotheby's received conversion requests totaling a principal amount of \$18.1 million from holders of the Convertible Notes. The resulting conversion obligation of \$22.5 million (\$18.1 million related to principal and approximately \$4.4 million related to the conversion premium) was settled entirely in cash by Sotheby's in August 2011. Sotheby's simultaneously received the \$4.4 million in cash paid to fund the conversion premium through its exercise of a portion of the related Convertible Note Hedges, which are intended to offset the impact of any conversion premium associated with Convertible Note redemptions. In the third quarter of 2011, Sotheby's recognized a \$1.5 million loss representing the write-off of a proportionate amount of unamortized discount and deferred transaction costs related to the Convertible Notes redeemed.

(See Note 6 of Notes to Condensed Consolidated Financial Statements.)

Other (Expense) Income

For the three and nine months ended September 30, 2011, Sotheby's results include other expense of \$1.1 million and \$1.5 million, respectively, as compared to other income of \$2.1 million and \$1.2 million, respectively, in the prior year. The unfavorable comparisons versus the prior year are largely the result of the significantly unfavorable performance of the trust assets related to the DCP liability, which resulted in losses of \$3.1 million and \$2.6 million for the three and nine months ended September 30, 2011, respectively. For the three and nine months ended September 30, 2010, other income included gains of \$1.6 million and \$0.3 million, respectively, from the changes in the fair value of these assets. On a consolidated basis, the impact of these gains (losses) in the trust assets related to the DCP are largely offset by corresponding adjustments to employee benefits costs (see "Salaries and Related Expenses" above for more information on the DCP.).

Income Tax Expense

Quarterly tax expense (benefit) is calculated using an estimated annual effective income tax rate for the period using actual historical information and forward looking estimates. The estimated annual effective income tax rate may fluctuate due to changes in forecasted annual pre-tax income, changes in the jurisdictional mix of forecasted pre-tax income and changes to actual or forecasted permanent book to tax differences (i.e., non-deductible expenses). Furthermore, the effective income tax rate may fluctuate as the result of positive or negative changes to the valuation allowance for net deferred tax assets and the impact of tax settlements with state, federal or foreign tax authorities; or the impact of tax law changes. Management identifies items which are unusual and non-recurring in nature and treats these as discrete events. The tax effect of discrete items is booked entirely in the quarter in which the discrete event occurs.

As discussed above, changes in the jurisdictional mix of forecasted pre-tax income could result in pre-tax income being higher or lower than anticipated in countries with lower statutory tax rates than the U.S., which could cause Sotheby's effective income tax rate to fluctuate. The impact of such changes could be meaningful in countries with statutory tax rates that are significantly lower than the U.S. statutory tax rate of 35%. This is particularly true in countries where Sotheby's has significant auction operations such as the U.K., Hong Kong, and Switzerland where the statutory tax rates are approximately 26%, 17%, and 23%, respectively. For the year ended December 31, 2010, the pre-tax income of the U.K., Hong Kong, and Switzerland was \$87.3 million, \$47.1 million, and \$18.5 million, respectively, which cumulatively comprised approximately 81% of foreign pre-tax income and approximately 68% of consolidated pre-tax income.

Management anticipates that Sotheby's annual effective income tax rate for 2011, excluding discrete items, will be approximately 27%. This anticipated annual effective income tax rate is lower than the U.S. statutory tax rate of 35% primarily due to foreign earnings taxed at lower rates, partially offset by state and local income taxes and additional U.S. tax on earnings from foreign subsidiaries. (See statement on Forward Looking Statements.)

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The table below summarizes Sotheby's income tax (benefit) / expense and effective tax rate for the three and nine months ended September 30, 2011 and 2010, including the impact of discrete items (in thousands of dollars):

| Three Months Ended September 30, | 2011 | 2010 |
|---|-------------|-------------|
| Loss before taxes | \$ (57,900) | \$ (38,482) |
| Income tax benefit | \$ (28,206) | \$ (18,948) |
| Effective tax rate | 48.7% | 49.2% |

| Nine Months Ended September 30, | 2011 | 2010 |
|--|-------------|-------------|
| Income before taxes | \$ 123,539 | \$ 85,668 |
| Income tax expense | \$ 23,631 | \$ 21,384 |
| Effective tax rate | 19.1% | 25.0% |

The change in Sotheby's effective income tax rate when compared to the prior year is largely due to an \$11.6 million benefit recognized in the third quarter of 2011 related to the reversal of a valuation allowance against certain of its deferred tax assets, as described in more detail below. The comparison to the prior periods is also impacted by a change to certain U.S. tax regulations governing the treatment of income earned by controlled foreign corporations. These tax regulations expired on December 31, 2009 and had an adverse impact on the forecasted 2010 annual effective income tax rate. However, these regulations were subsequently extended in December 2010 through December 31, 2011, with this extension being applied retroactively from January 1, 2010. Additionally, the effective income tax rate for the three and nine months ended September 30, 2010 was impacted by the recording of a discrete benefit of \$6 million related to previously unrecognized tax benefits due to the expiration of the federal statutory period for 2006.

Accounting Standards Codification (ASC) 740 (*Income Taxes*) requires a valuation allowance to be established when it is more likely than not that all or a portion of the deferred tax assets will not be realized. In circumstances where there is sufficient negative evidence, establishment of a valuation allowance must be considered. A cumulative loss in the most recent three-year period represents sufficient negative evidence to consider a valuation allowance under the provisions of ASC 740. In 2009, as a result of cumulative three year losses in certain state and local jurisdictions and management's assessment of Sotheby's ability to utilize certain state and local deferred tax assets, including net operating losses against projected income, a valuation allowance was established.

As of the third quarter of 2011, Sotheby's is no longer in a cumulative three year loss position in the state and local jurisdictions in which it had established the valuation allowance against its deferred tax assets. As a result, management assessed whether there was sufficient positive evidence to conclude that it is more likely than not that these deferred tax assets will be realized and that the valuation allowance is no longer required. This sufficient positive evidence included, but was not limited to, recent profitability, management's expectation of future profitability, the expected timing of the reversals of the deferred tax assets and the present economic conditions as compared to the economic conditions when the valuation allowance was established. Based on this assessment, in the third quarter of 2011, management concluded that it is more likely than not that these deferred tax assets will be realized and, as a result, Sotheby's reversed the valuation allowance. The reversal of the valuation allowance resulted in the recognition of an \$11.6 million benefit recorded through the third quarter of 2011, which included a discrete benefit of \$9.6 million recognized in the third quarter and an additional benefit of \$2 million being recognized through its annual effective income tax rate. In the fourth quarter of 2011, an additional benefit of \$2 million will be recognized through Sotheby's effective income tax rate. (See statement on Forward Looking Statements.)

Impact of Changes in Foreign Currency Exchange Rates

For the three and nine months ended September 30, 2011, changes in foreign currency exchange rates had a net unfavorable impact of approximately \$1.3 million and a net favorable impact of approximately \$9.8 million, respectively, on Sotheby's results. The components of the impact of changes in foreign currency exchange rates are as follows (in thousands of dollars):

| Three Months Ended September 30, 2011 | Favorable/ (Unfavorable) |
|--|-------------------------------------|
| Total revenues | \$ 1,794 |
| Total expenses | (3,394) |

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| | |
|---|-------------------|
| Operating loss | (1,600) |
| Net interest expense and other | 252 |
| Impact of changes in foreign currency exchange rates | \$ (1,348) |

| | Favorable/ (Unfavorable) |
|---|-------------------------------------|
| Nine Months Ended September 30, 2011 | |
| Total revenues | \$ 22,816 |
| Total expenses | (12,994) |
| Operating income | 9,822 |
| Net interest expense and other | 13 |
| Impact of changes in foreign currency exchange rates | \$ 9,835 |

Table of Contents**CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

The following table summarizes Sotheby's material contractual obligations and commitments as of September 30, 2011 (in thousands of dollars):

| | Total | Less Than One Year | Payments Due by Period 1 to 3 Years | 3 to 5 Years | After 5 Years |
|--|-------------------|-----------------------|---|-------------------|------------------|
| <u>York Property Mortgage (1)</u> | | | | | |
| Principal | \$ 231,508 | \$ 3,177 | \$ 6,972 | \$ 221,359 | \$ |
| Interest | 48,023 | 12,827 | 25,036 | 10,160 | |
| Sub-total | 279,531 | 16,004 | 32,008 | 231,519 | |
| <u>Unsecured debt (2)</u> | | | | | |
| Principal payments | 261,839 | | 181,868 | 79,971 | |
| Interest payments | 34,367 | 11,881 | 18,079 | 4,407 | |
| Sub-total | 296,206 | 11,881 | 199,947 | 84,378 | |
| <u>Other commitments:</u> | | | | | |
| Operating lease obligations (3) | 110,642 | 15,417 | 26,338 | 24,450 | 44,437 |
| Employment arrangements (4) | 22,112 | 9,405 | 9,771 | 2,383 | 553 |
| Auction guarantees (5) | 78,000 | 78,000 | | | |
| Uncertain tax positions (6) | | | | | |
| Sub-total | 210,754 | 102,822 | 36,109 | 26,833 | 44,990 |
| Total | \$ 786,491 | \$ 130,707 | \$ 268,064 | \$ 342,730 | \$ 44,990 |

- (1) Represents the outstanding principal and monthly interest payments due on the York Property Mortgage. The York Property Mortgage matures on July 1, 2035, has an optional pre-payment date of July 1, 2015, and bears an annual interest rate of approximately 5.6%, which increases subsequent to July 1, 2015. It is Sotheby's current intention to either pre-pay or refinance the mortgage on or about July 1, 2015.
- (2) Represents the aggregate outstanding principal and semi-annual interest payments due on Sotheby's \$80 million 7.75% Senior Notes (the Senior Notes) and \$181 million 3.125% Convertible Notes (the Convertible Notes). The Senior Notes are due on June 15, 2015. The Convertible Notes are due on June 15, 2013, but may be converted at any time beginning on March 15, 2013 and ending on the close of business on June 14, 2013. Prior to March 15, 2013, the Convertible Notes may only be converted: (1) during any fiscal quarter (and only during such fiscal quarter), if the closing price of Sotheby's Common Stock exceeds \$44.20 per share (i.e., 130% of the conversion price of the Convertible Notes) for at least 20 trading days in the period of 30 consecutive trading days at the end of the previous quarter, (2) if the trading price of the Convertible Notes falls below a certain threshold over a defined period, or (3) upon the occurrence of certain specified corporate transactions (as set forth in the Convertible Notes Indenture). It is Sotheby's current intent and policy to settle up to the principal amount of the Convertible Notes in cash. (See Note 6 of Notes to Condensed Consolidated Financial Statements for additional information on the Convertible Notes and the Senior Notes.)
- (3) Represents rental payments due under Sotheby's operating lease obligations.
- (4) Represents the remaining commitment for future salaries and other cash compensation (excluding any participation in Sotheby's incentive compensation and share-based payment programs) related to employment arrangements with certain senior employees, which expire at various points between February 2012 and March 2017. Such arrangements may provide, among other benefits, for minimum salary levels and for incentive compensation under Sotheby's incentive compensation programs which is payable only if specified company and individual goals are attained. Additionally, certain of these arrangements provide for annual equity grants, the accelerated vesting of certain equity grants, severance payments, other cash compensation, and continuation of benefits upon termination of employment under certain circumstances.

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- (5) From time to time in the ordinary course of its business, Sotheby's will guarantee to consignors a minimum sale price in connection with the sale of property at auction (an auction guarantee). As of September 30, 2011, Sotheby's had outstanding auction guarantees totaling \$78 million, with most of the individual properties under the outstanding auction guarantees having a presale low estimate approximately equal to the guaranteed price. Sotheby's financial exposure under these auction guarantees is reduced by irrevocable bids from unaffiliated third parties. If the irrevocable bids are the winning bids for the property underlying these auction guarantees, the total proceeds from the irrevocable bidders, including buyer's premium, would be no less than the aggregate amount of these auction guarantees. All of the property related to such auction guarantees is being offered at auctions in the fourth quarter of 2011. As of September 30, 2011, \$10 million of the guaranteed amount had been advanced by Sotheby's and was recorded within Notes Receivable and Consignor Advances on its balance sheet. (See Note 10 of Notes to Condensed Consolidated Financial Statements and Off Balance Sheet Arrangements below for more information related to auction guarantees. See Note 5 of Notes to Condensed Consolidated Financial Statements for more information on Notes Receivable and Consignor Advances.)
- (6) Excludes the \$20 million liability recorded for uncertain tax positions that would be settled by cash payments to the respective taxing authorities, which are classified as long-term liabilities in the September 30, 2011 Condensed Consolidated Balance Sheet. This liability is excluded from the table above because management is unable to make reliable estimates of the period of settlement with the respective taxing authorities. (See Note 13 of Notes to Condensed Consolidated Financial Statements for more detailed information on uncertain tax positions.)

OFF BALANCE SHEET ARRANGEMENTS**Auction Guarantees**

From time to time in the ordinary course of its business, Sotheby's will guarantee to consignors a minimum sale price in connection with the sale of property at auction (an auction guarantee). In the event that the property sells for less than the guaranteed price, Sotheby's must perform under the auction guarantee by funding the difference between the sale price at auction and the amount of the auction guarantee. Sotheby's is generally entitled to a share of the excess proceeds (the overage) if the property under the auction guarantee sells above the guaranteed price. If the property does not sell, the amount of the auction guarantee must be paid, but Sotheby's has the right to recover such amount through the future sale of the property. In these situations, the guaranteed property is recorded as Inventory on Sotheby's balance sheet at the lower of cost (i.e., the amount paid under the auction guarantee) or management's estimate of the property's net realizable value (i.e., expected sale price upon disposition). The sale proceeds ultimately realized by Sotheby's in these situations may equal, exceed or be less than the amount recorded as Inventory on Sotheby's balance sheet.

Sotheby's may reduce its financial exposure under auction guarantees through risk and reward sharing arrangements, which include:

Contractual arrangements under which a counterparty contractually commits to bid a predetermined price for the guaranteed property (an irrevocable bid). If the irrevocable bid is the winning bid, the counterparty purchases the property at the predetermined price plus the applicable buyer's premium, which is the same amount that any other successful bidder would pay at that price. If the irrevocable bid is not the winning bid, the counterparty is generally entitled to receive a share of the auction commission earned on the sale and/or a share of any overage.

Contractual arrangements under which a counterparty contractually commits to fund: (i) a share of the difference between the sale price at auction and the amount of the auction guarantee, if the property sells for less than the guaranteed price, or (ii) a share of the guaranteed price if the property does not sell while taking ownership of a proportionate share of the unsold property. In exchange for accepting a share of the financial exposure under the auction guarantee, if the property sells, the counterparty is entitled to receive a share of the auction commission earned on the sale and/or a share of any overage.

The counterparties to these auction guarantee risk and reward sharing arrangements are typically major international art dealers or major art collectors. Sotheby's could be exposed to losses in the event any of these counterparties do not perform according to the terms of these contractual arrangements.

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As of September 30, 2011, Sotheby's had outstanding auction guarantees totaling \$78 million, with most of the individual properties under the outstanding auction guarantees having a presale low estimate approximately equal to the guaranteed price. Sotheby's financial exposure under these auction guarantees is reduced by irrevocable bids from unaffiliated third parties. If the irrevocable bids are the winning bids for the property underlying these auction guarantees, the total proceeds from the irrevocable bidders, including buyer's premium, would be no less than the aggregate amount of these auction guarantees. All of the property related to such auction guarantees is being offered at auctions in the fourth quarter of 2011. As of September 30, 2011, \$10 million of the guaranteed amount had been advanced by Sotheby's and is recorded on the balance sheet within Notes Receivable and Consignor Advances. As of September 30, 2011, December 31, 2010 and September 30, 2010, the carrying amount of the liability representing the estimated fair value of Sotheby's obligation to perform under its auction guarantees was approximately \$0.2 million, \$0.1 million and \$0.2 million, respectively, and is recorded on the balance sheet within Accounts Payable and Accrued Liabilities.

As of November 3, 2011, Sotheby's had outstanding auction guarantees totaling \$70.4 million, with most of the individual properties under the outstanding auction guarantees having a presale low estimate approximately equal to the guaranteed price. Sotheby's financial exposure under these auction guarantees is reduced by irrevocable bids from unaffiliated third parties. If the irrevocable bids are the winning bids for the property underlying these auction guarantees, the total proceeds from the irrevocable bidders, including buyer's premium, would be no less than the amount of these auction guarantees. All of the property related to such auction guarantees is being offered at auctions in the fourth quarter of 2011.

CONTINGENCIES

For information related to Contingencies, see Notes 5, 9, 10 and 13 of Notes to Condensed Consolidated Financial Statements.

UNCERTAIN TAX POSITIONS

For information related to uncertain tax positions, see Note 13 of Notes to Condensed Consolidated Financial Statements.

FINANCIAL CONDITION AS OF SEPTEMBER 30, 2011

Cash Provided by Operating Activities The amount of cash provided or used by Sotheby's operating activities in a period is generally a reflection of the volume of Net Auction Sales, the timing of auction sale settlements (see Note 5 of Notes to Condensed Consolidated Financial Statements), the timing of payments made to vendors, the amount and timing of compensation-related payments and the timing of the collection and/or payment of tax-related amounts. Net cash provided by operating activities of \$58.9 million for the nine months ended September 30, 2011 is principally a reflection of Sotheby's net income during the period, partially offset by tax-related payments of \$53.1 million and the timing of compensation-related payments.

Cash Provided by Investing Activities Net cash provided by investing activities of \$43.9 million for the nine months ended September 30, 2011 is principally attributable to net cash inflows of \$60.1 million related to notes receivable in the period, as loan settlements exceeded new loans during the period. This net cash inflow is partially offset by \$13 million in capital expenditures, a portion of which were made to support certain Sotheby's strategic initiatives, including the further enhancement of the sothebys.com website and investments made to enhance Sotheby's private sale exhibition space.

Cash Used by Financing Activities Net cash used by financing activities of \$39.2 million for the nine months ended September 30, 2011 is principally due to the settlement of Convertible Note redemptions (\$18.1 million, net of proceeds from the exercise of the Convertible Note Hedges, as discussed in Note 6 of Notes to Condensed Consolidated Financial Statements.), the funding of employee tax obligations upon the vesting of share-based payments during the period (\$18.6 million) and dividend payments of \$10.3 million. These financing cash outflows are partially offset by \$7.2 million in excess tax benefits resulting from the vesting and exercise of share-based payments during the period. Due to the appreciation of Sotheby's stock price, such share-based payments vested at values higher than what was recorded as expense in Sotheby's statements of operations. Such circumstances result in a higher tax deduction for Sotheby's. (See Note 12 of Notes to Condensed Consolidated Financial Statements.)

Table of Contents**NET CASH (DEBT)**

The table below summarizes Sotheby's net cash (debt) position as of September 30, 2011, December 31, 2010 and September 30, 2010 (in thousands of dollars):

| | September 30, 2011 | December 31, 2010 | September 30, 2010 |
|---|-----------------------|----------------------|-----------------------|
| Cash and cash equivalents | \$ 542,400 | \$ 483,663 | \$ 345,617 |
| Debt: | | | |
| Convertible Notes (\$182 million principal value, due June 2013) | 168,431 | 179,335 | 177,448 |
| Senior Notes (\$80 million principal value, due June 2015) | 79,180 | 79,073 | 126,905 |
| York Property Mortgage (\$232 million principal value, due July 2015) | 218,167 | 217,538 | 217,624 |
| Total debt | 465,778 | 475,946 | 521,977 |
| Net cash (debt) | \$ 76,622 | \$ 7,717 | \$ (176,360) |

The improvement in Sotheby's net cash (debt) position as of September 30, 2011 when compared to September 30, 2010 is primarily attributable to a significantly higher level of cash, which is attributable to a higher level of earnings during the twelve months ended September 30, 2011.

LIQUIDITY AND CAPITAL RESOURCES

Cash and Cash Equivalents As of September 30, 2011, Sotheby's had cash and cash equivalents of approximately \$542.4 million, of which \$36.9 million was held in the U.S. and \$504.4 million was held by foreign subsidiaries. The focus of Sotheby's current investment policy is to preserve principal and ensure short-term liquidity. Accordingly, current cash balances are invested in overnight deposits at the highest rated banks.

Revolving Credit Facility On August 31, 2009, Sotheby's and certain of its wholly-owned subsidiaries (collectively, the Borrowers) entered into a credit agreement (the Credit Agreement) with an international syndicate of lenders led by General Electric Capital Corporation (GE Capital). The credit agreement was amended by Sotheby's, GE Capital and the lenders named therein (collectively, the Lenders) on November 23, 2010. This amendment, among other things, extended the maturity date of the Credit Agreement, reduced borrowing costs and fees, and provided additional flexibility to Sotheby's.

The following summary does not purport to be a complete summary of the Credit Agreement, as amended, and is qualified in its entirety by reference to the Credit Agreement and each of the respective amendments, copies of which were filed as exhibits to previous SEC filings. Terms used, but not defined in this summary, have the meanings set forth in the Credit Agreement and each of the respective amendments.

The Credit Agreement, as amended, provides for a \$200 million revolving credit facility (the Revolving Credit Facility), subject to a borrowing base, and has a feature whereby any time on or before March 1, 2014 the Borrowers may request, with Lenders' approval, to increase the borrowing capacity by an amount not to exceed \$50 million. In addition, up to \$10 million of the Revolving Credit Facility may be used to issue letters of credit. As of September 30, 2011, no borrowings were outstanding, and the amount of available borrowings under the Revolving Credit Facility was approximately \$103.2 million, as calculated under the borrowing base. Sotheby's has not borrowed or issued any letters of credit under the Revolving Credit Facility since its inception.

Borrowings under the Revolving Credit Facility are available in either Dollars to U.S. Borrowers or Pounds Sterling to U.K. Borrowers. The U.S. Borrowers and, subject to certain limitations, the U.K. Borrowers, are jointly and severally liable for all obligations under the Credit Agreement, as amended. In addition, certain subsidiaries of the Borrowers guarantee the obligations of the Borrowers under the Credit Agreement, as amended. The obligations under the Credit Agreement, as amended, are secured by liens on all or substantially all of the personal property of the Borrowers and the Guarantors. Borrowings are, at the Borrowers' option, either Dollar Index Rate Loans (for U.S. Borrowers only) or LIBOR Rate Loans. Dollar Index Rate Loans bear interest at a rate per annum equal to (a) the highest of (i) the Prime Rate as quoted in *The Wall Street Journal*, (ii) the Federal Funds Rate plus 0.50%, or (iii) the LIBOR Rate plus 1.0%, plus (b) the Applicable Margin, as defined in the Credit Agreement, as amended, and which is generally 1.50% to 2.00% based upon the level of outstanding borrowings under the

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Revolving Credit Facility. The LIBOR Rate for Dollars or Sterling, as the case may be, for an interest period is equal to (x) the offered rate for deposits in such currency for a period equal to such interest period on the Reuters Screen LIBOR01 Page, plus (y) the Applicable Margin, as defined in the Credit Agreement, as amended, and which is generally 2.50% to 3.00% based upon the level of outstanding borrowings under the Revolving Credit Facility.

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The Credit Agreement, as amended, contains certain customary affirmative and negative covenants including, but not limited to, limitations on capital expenditures, limitations on net outstanding auction guarantees (auction guarantees less the impact of risk and reward sharing arrangements) and limitations on the use of proceeds from borrowings under the Credit Agreement, as amended. The Credit Agreement, as amended, also restricts quarterly dividend payments to the lesser of \$0.10 per share or \$8 million. However, the maximum level of quarterly dividend payments may be increased depending upon Sotheby's achievement of a certain Fixed Charge Coverage Ratio in any period. Management believes that Sotheby's is in compliance with the covenants and terms of the Credit Agreement, as amended.

The Credit Agreement, as amended, also contains certain financial covenants, which are only applicable during certain compliance periods. These financial covenants were not applicable for the twelve month period ended September 30, 2011.

The maturity date of the Credit Agreement, as amended, is September 1, 2014, subject to Sotheby's meeting certain liquidity requirements during the period commencing on December 15, 2012 and ending on the date Sotheby's 3.125% Convertible Notes (the "Convertible Notes") are converted or discharged.

Liquidity and Capital Requirements Sotheby's generally relies on operating cash flows and existing cash balances, supplemented by Revolving Credit Facility borrowings, if needed, to meet its liquidity and capital requirements. The timing and extent of any borrowings under the Revolving Credit Facility is dependent upon a number of factors including, but not limited to, the cyclical nature of the global art market, the seasonality of Sotheby's business, the timing of auction sale settlements and the funding of notes receivable and consignor advances.

As of September 30, 2011, Sotheby's had cash and cash equivalents of approximately \$542.4 million, of which \$36.9 million was held in the U.S. and \$504.4 million was held by foreign subsidiaries. Of the \$504.4 million in foreign cash balances, approximately \$444.4 million would be subject to additional income taxes if repatriated. Based on current projections and management's planned use of foreign cash balances, it is expected that this \$444.4 million in foreign cash will be indefinitely reinvested outside of the U.S. and will not need to be repatriated to fund Sotheby's U.S. operations or debt repayments. (See statement on Forward Looking Statements.)

Sotheby's short-term operating needs and capital requirements include the funding of working capital, the funding of notes receivable and consignor advances, the funding of debt repayments, the funding of capital expenditures and the payment of dividends, as well as the funding of the other short-term commitments due on or before September 30, 2012 as summarized in the table of contractual obligations and commitments above. Capital expenditures are expected to be in the range of \$18 million to \$22 million for the year ended December 31, 2011. The expected higher level of capital expenditures as compared to 2010 is due, in part, to expenditures to support certain of Sotheby's strategic initiatives, including investments in the enhancement of the Sothebys.com website and Sotheby's private sale exhibition space in New York. Management also expects to invest in the range of \$7 million in 2012 for the expansion of Sotheby's premises in Hong Kong. (See statement on Forward Looking Statements.)

Sotheby's long-term operating needs and capital requirements include the funding of working capital, the funding of notes receivable and consignor advances, the funding of capital expenditures, as well as the funding of the presently anticipated long-term contractual obligations and commitments summarized in the table of contractual obligations and commitments above.

Management believes that operating cash flows and existing cash balances, supplemented by Revolving Credit Facility borrowings, if needed, will be adequate to meet Sotheby's anticipated short-term and long-term commitments, operating needs and capital requirements through the September 1, 2014 expiration of the Credit Agreement, as amended.

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Sotheby's 3.125% Convertible Notes were convertible at the option of the holders during the fiscal quarter beginning on April 1, 2011 and ending on June 30, 2011. In June 2011, Sotheby's received conversion requests totaling a principal amount of \$18.1 million from holders of the Convertible Notes. The conversion obligation of \$22.5 million related to these conversion requests, which consisted of \$18.1 million related to principal and approximately \$4.4 million related to the conversion premium, was settled entirely in cash in August 2011. Sotheby's simultaneously received \$4.4 million in cash to fund the conversion premium through its exercise of a portion of the convertible note hedges, which are intended to offset the impact of any conversion premium associated with Convertible Note redemptions. (See Note 6 of Notes to Condensed Consolidated Financial Statements.)

The Stock Price Trigger related to the Convertible Notes was not met during the second or third quarter of 2011. Therefore, the \$182 million in principal amount of the Convertible Notes that remain outstanding following the conversions discussed above will continue to have a maturity date of June 15, 2013.

On November 7, 2011, Sotheby's Board of Directors approved a 60% increase to the quarterly dividend rate (from \$0.05 per share to \$0.08 per share) and declared a quarterly dividend of \$0.08 per share (approximately \$5.4 million) to be paid to shareholders of record as of December 1, 2011 on December 15, 2011.

The declaration and payment of future dividends to shareholders is at the discretion of Sotheby's Board of Directors and will depend on many factors, including Sotheby's financial condition, cash flows, legal requirements and other factors as the Board of Directors deems relevant. It is the intention of Sotheby's to continue to pay quarterly dividends at a rate of at least \$0.08 per share, subject to Board approval and depending on economic, financial, market and other conditions at the time. (See statement on Forward Looking Statements.)

In light of Sotheby's significant cash balances and liquidity position, management will continue to monitor whether to invest its excess liquidity in operations, as well as in traditional corporate finance alternatives, including further repurchases of the 7.75% Senior Notes, some action with respect to the dividend and/or a repurchase of shares of Common Stock, subject to prevailing financial markets, and economic and business conditions.

FUTURE IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-13, *Multiple-Deliverable Revenue Arrangements*, which is codified in ASC 605, *Revenue Recognition*. This update addresses the unit of accounting for arrangements involving multiple deliverables and how to allocate arrangement consideration to one or more units of accounting. It eliminates the criteria that objective and reliable evidence of the fair value of any undelivered items must exist for the delivered items to be considered separate units of accounting. This update was effective starting in the first quarter of 2011 and did not impact Sotheby's financial statements.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*, which is codified in ASC 220, *Comprehensive Income*. This update eliminates the option for entities to present the components of other comprehensive income as part of the statement of changes in shareholder's equity and requires entities to report the components of comprehensive income (i.e., net income and other comprehensive income) in either: (1) a single, continuous statement of comprehensive income or (2) two separate, but consecutive, statements. ASU 2011-05 does not change the items that must be reported in other comprehensive income and does not require incremental disclosures in addition to those already required by ASC 220. This update will be effective for Sotheby's quarterly and annual financial statements beginning in the first quarter of 2012. Management is currently evaluating the adoption alternatives provided by ASU 2011-05.

In September 2011, the FASB issued ASU 2011-08, *Intangibles - Goodwill and Other: Testing Goodwill for Impairment*, which is codified in ASC 350, *Intangibles - Goodwill and Other*. This update gives entities testing goodwill for impairment the option of performing a qualitative assessment before calculating the fair value of a reporting unit in step 1 of the goodwill impairment test. If entities determine, on the basis of qualitative factors, that the fair value of a reporting unit is more likely than not less than the carrying amount, the two-step impairment test would be required. Otherwise, further testing would not be needed. This update will be effective for Sotheby's quarterly and annual financial statements beginning in the first quarter of 2012. Early adoption is permitted. Management is currently evaluating the potential impact of electing to perform the qualitative assessment allowed under ASU 2011-08.

RECENT LEGISLATION

In March 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 were signed into law in the U.S. This legislation expands health care coverage to many uninsured individuals and expands coverage to those already insured. The changes required by this legislation could result in additional health care and other costs for Sotheby's. Management does not expect any material short-term impact on Sotheby's financial results as a result of the legislation but will continue to assess the extent of any future impact. Sotheby's

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does not provide retiree health benefits, and therefore will not be impacted by the elimination of the tax deductibility of the Medicare Part D subsidy resulting from this legislation. (See statement on Forward Looking Statements.)

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was signed into law in the U.S. This legislation will significantly change the current banking and financial institution regulatory structure and affect the lending, deposit, investment, trading and operating activities of such financial institutions. Management continues to review the provisions of the Dodd-Frank Act, and its associated regulations, many of which will be phased-in over time, and to assess their impact on Sotheby s operations.

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FORWARD LOOKING STATEMENTS

This Form 10-Q contains certain forward looking statements; as such term is defined in Section 21E of the Securities Exchange Act of 1934, as amended, relating to future events and the financial performance of Sotheby's. Such 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. Major factors which could cause the actual results to differ materially from the predicted results in the forward looking statements include, but are not limited to, the factors listed below under Part II, Item 1A, Risk Factors, which are not ranked in any particular order.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Sotheby's continually evaluates the market risk associated with its financial instruments in the normal course of its business. As of September 30, 2011, Sotheby's material financial instruments include: (i) cash and cash equivalents, (ii) restricted cash, (iii) notes receivable, (iv) the trust assets related to its deferred compensation liability, (v) the York Property Mortgage, (vi) its 7.75% Senior Notes, (vii) its 3.125% Convertible Notes, (viii) its deferred compensation liability and (ix) its outstanding forward exchange contracts.

Management believes that the interest rate risk associated with its financial instruments is minimal as a hypothetical 10% increase or decrease in interest rates is immaterial to its cash flow, earnings, and the fair value related to its financial instruments.

As of September 30, 2011, a hypothetical 10% strengthening or weakening of the U.S. dollar relative to all other currencies would result in a decrease or increase in cash flow of approximately \$45.3 million.

ITEM 4: CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of September 30, 2011, Sotheby's has carried out an evaluation, under the supervision and with the participation of Sotheby's management, including Sotheby's Chief Executive Officer and Chief Financial Officer, of the effectiveness of Sotheby's disclosure controls and procedures. Based upon that evaluation, Sotheby's Chief Executive Officer and Chief Financial Officer have concluded that Sotheby's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) were effective as of September 30, 2011.

Changes in Internal Control over Financial Reporting

There was no change in Sotheby's internal control over financial reporting that occurred during Sotheby's most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, Sotheby's internal control over financial reporting.

PART II: OTHER INFORMATION

ITEM 1: LEGAL PROCEEDINGS

Sotheby's becomes involved in various claims and lawsuits incidental to the ordinary course of its business, including the matter described below. While it is not possible to predict the outcome of litigation, management does not believe that the outcome of any of these pending claims or proceedings will have a material adverse effect on Sotheby's consolidated results of operations, financial condition and/or cash flows.

Estate of Robert Graham, et al. v. Sotheby's, Inc. is a purported class action commenced in the United States District Court for the Central District of California in October 2011 on behalf of U.S. artists (and their estates) whose artworks were sold by Sotheby's in the State of California or at auction by California sellers and for which a royalty was allegedly due under the California Resale Royalties Act (the Resale Royalties Act). Plaintiffs seek unspecified damages, punitive damages and injunctive relief for alleged violations of the Resale Royalties Act and the California Unfair Competition Law. It is currently not possible to make an estimate of the amount or range of loss that could result from an unfavorable outcome of this matter. Sotheby's believes that there are meritorious defenses to the claims asserted by plaintiffs, and they will be vigorously defended.

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ITEM 1A: RISK FACTORS

Sotheby's operating results and liquidity are significantly influenced by a number of risk factors, many of which are not within its control. These factors, which are not ranked in any particular order, are discussed below.

The global economy and the financial markets and political conditions of various countries may negatively affect Sotheby's business and customers, as well as the supply of and demand for works of art.

The international art market is influenced over time by the overall strength and stability of the global economy and the financial markets of various countries, although this correlation may not be immediately evident. In addition, global political conditions and world events may affect Sotheby's business through their effect on the economies of various countries, as well as on the willingness of potential buyers and sellers to purchase and sell art in the wake of economic uncertainty. Sotheby's business can be particularly influenced by the economies, financial markets and political conditions of the U.S., the U.K., China and the other major countries or territories of Europe and Asia. Accordingly, weakness in those economies and financial markets can adversely affect the supply of and demand for works of art and Sotheby's business. Furthermore, global political conditions may also influence the enactment of legislation that could adversely impact Sotheby's business.

Government laws and regulations may restrict or limit Sotheby's business.

Many of Sotheby's activities are subject to laws and regulations including, but not limited to, import and export regulations, cultural property ownership laws, data protection and privacy laws, anti-money laundering laws, antitrust laws, copyright and resale royalty laws and value added sales taxes. In addition, Sotheby's is subject to local auction regulations, such as New York City Auction Regulations Subchapter M of Title 6 §§ 2-121 2-125, et. seq. Such regulations do not impose a material impediment to the worldwide business of Sotheby's, but do affect the market generally, and a material adverse change in such regulations could affect its business. Additionally, export and import laws and cultural property ownership laws could affect the availability of certain kinds of property for sale at Sotheby's principal auction locations or could increase the cost of moving property to such locations.

Foreign currency exchange rate movements can significantly increase or decrease Sotheby's results of operations.

Sotheby's has operations throughout the world, with approximately 59% of its revenues earned outside of the U.S. in 2010. Revenues and expenses relating to Sotheby's foreign operations are translated using weighted average monthly exchange rates during the period in which they are recognized. Accordingly, fluctuations in foreign currency exchange rates, particularly for the Pound Sterling and the Euro, can significantly increase or decrease Sotheby's results of operations.

Competition in the international art market is intense and may adversely impact Sotheby's results of operations.

Sotheby's competes with other auctioneers and art dealers to obtain valuable consignments to offer for sale either at auction or through private sale. The level of competition is intense and can adversely impact Sotheby's ability to obtain valuable consignments for sale, as well as the commission margins achieved on such consignments.

Sotheby's cannot be assured of the amount and quality of property consigned for sale at auction, which may cause significant variability in its financial results.

The amount and quality of property consigned for sale is influenced by a number of factors not within Sotheby's control. Many major consignments, and specifically single-owner sale consignments, often become available as a result of the death or financial or marital difficulties of the owner, all of which are unpredictable and may cause significant variability in Sotheby's financial results from period to period.

The demand for art is unpredictable, which may cause significant variability in Sotheby's financial results.

The demand for art is influenced not only by overall economic conditions, but also by changing trends in the art market as to which collecting categories and artists are most sought after and by the collecting preferences of individual collectors, all of which are difficult to predict and which may adversely impact the ability of Sotheby's to obtain and sell consigned property, potentially causing significant variability in Sotheby's financial results from period to period.

The loss of key personnel could adversely impact Sotheby's ability to compete.

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Sotheby's is largely a service business in which the ability of its employees to develop and maintain relationships with potential sellers and buyers of works of art is essential to its success. Moreover, Sotheby's business is unique, making it important to retain key specialists and members of management. Accordingly, Sotheby's business is highly dependent upon its success in attracting and retaining qualified personnel.

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Sotheby's ability to conduct business at its New York City office could be disrupted by a work stoppage involving unionized employees.

On June 30, 2011, the collective bargaining agreement applicable to 42 property handlers employed at Sotheby's New York City office expired. During the process of negotiations with the union representing the property handlers, the union made statements to the media threatening a strike. In order to avoid the impact of the union's threatened strike during the upcoming sales season and in support of Sotheby's bargaining proposals, Sotheby's locked out members of the bargaining unit on July 29, 2011. Although management cannot predict the ultimate outcome of the negotiations and any associated work disruption, Sotheby's is committed to a good faith bargaining process and resolution of this matter. In the interim, Sotheby's ability to conduct business at its New York City office could be disrupted by the lockout, though management has contingency plans in place to minimize any potential disruption that could be caused by the lockout. The union has also initiated a broader campaign to try to influence Sotheby's clients and suppliers to support the union and cease doing business with Sotheby's. It is impossible to predict the impact of this union campaign, but to-date, the campaign has not had a material impact on Sotheby's business.

The strategic initiatives and restructuring plan being implemented by Sotheby's may not succeed.

Sotheby's current core strategic initiatives are focused on extending the breadth and depth of its relationships with major clients, developing a presence in China and other emerging markets, and enhancing its ability to conduct private sales. Over the past several years, Sotheby's has made substantial investments in information technology to provide clients with real-time access to their account data and on-line bidding, improve post-sale client service, and enhance the Sothebys.com website. In addition, Sotheby's has continued to host innovative private selling exhibitions, and, in 2011, completed the construction of an enhanced private sales gallery at its New York headquarters. Sotheby's is also implementing a restructuring plan whereby it is streamlining certain European selling operations to allow global management to focus resources on growing markets, especially China, and other strategic priorities.

Sotheby's future operating results are dependent in part on management's success in implementing these initiatives. Furthermore, the inability of Sotheby's to successfully implement these initiatives could result in, among other things, the loss of clients, the impairment of assets, and inefficiencies from operating in new and emerging markets. Sotheby's short-term operating results could also be unfavorably impacted by the costs associated with the implementation of its strategic plans. (See statement on Forward Looking Statements.)

A breach of the security measures protecting Sotheby's global network of information systems may occur.

Sotheby's is dependent on a global network of information systems to conduct its business. A breach of the security measures protecting Sotheby's information systems could adversely impact its operations, reputation and brand.

Sotheby's business continuity plans may not be effective in addressing the impact of unexpected events that could impact its business.

Sotheby's inability to successfully implement its business continuity plans in the wake of unexpected events could disrupt its ability to operate and adversely impact its operations.

Sotheby's relies on a small number of clients who make a significant contribution to its revenues, profitability and operating cash flows.

Sotheby's relies on a small number of clients who make a significant contribution to its revenues, profitability and operating cash flows. Accordingly, Sotheby's revenues, profitability and operating cash flows are highly dependent upon its ability to develop and maintain relationships with this small group of clients, as well as the financial strength of these clients.

In certain limited circumstances, Sotheby's will pay the consignor before payment is collected from the buyer and/or allows the buyer to take possession of the property before payment is received.

Under the standard terms and conditions of its auction sales, Sotheby's is not obligated to pay consignors for property that has not been paid for by buyers. However, in certain limited instances, Sotheby's will pay the consignor before payment is collected from the buyer while retaining possession of the property. In such situations, if the buyer does not make payment, Sotheby's will take title to the property, but could be exposed to losses if the value of the property declines. In other certain limited instances, Sotheby's allows the buyer to take possession of the property before payment is received. In these situations, Sotheby's is liable to the seller for the net sale proceeds whether or not the buyer makes payment and would incur losses in the event of buyer default.

Sotheby's ability to collect auction receivables may be adversely impacted by the banking and foreign currency laws and regulations, as well as the judicial systems, of the countries in which it operates and in which its clients reside.

Sotheby's operates in 40 countries and has a worldwide client base. The collection of auction receivables may be adversely impacted by the banking and foreign currency laws and regulations regarding the movement of funds out of certain countries, as well by Sotheby's ability to enforce its rights as a creditor in jurisdictions where the applicable laws and regulations may be less defined, particularly in emerging markets.

Demand for art-related financing is unpredictable, which may cause variability in Sotheby's financial results.

Sotheby's business is, in part, dependent on the demand for art-related financing, which can be significantly influenced by overall economic conditions and by the often unpredictable financial requirements of owners of major art collections. Accordingly, the financial results of Sotheby's Finance segment are subject to variability from period to period.

The ability of Sotheby's to realize proceeds from the sale of collateral for Finance segment loans may be limited or delayed.

In situations when there are competing claims on the collateral for Finance segment loans and/or when a borrower becomes subject to bankruptcy or insolvency laws, Sotheby's ability to realize proceeds from the sale of its collateral may be limited or delayed.

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The value of art is subjective and often fluctuates, exposing Sotheby's to losses in the value of its inventory and loan collateral and significant variability in its financial results.

The art market is not a highly liquid trading market. As a result, the valuation of art is inherently subjective, and the realizable value of art often fluctuates over time. Accordingly, Sotheby's is at risk both as to the realizable value of art held in inventory and as to the realizable value of art pledged as collateral for Finance segment loans.

In estimating the realizable value of art, management relies upon the opinions of Sotheby's specialists, who consider the following complex array of factors when valuing art: (i) whether the artwork is expected to be offered at auction or sold privately in the normal course of business; (ii) the supply and demand for works of art, taking into account economic conditions and changing trends in the art market as to which collecting categories and artists are most sought after and (iii) recent sale prices achieved in the art market for comparable works of art within a particular collecting category and/or by a particular artist.

If the estimated realizable value of a specific artwork held in inventory is less than its carrying value, a loss is recorded to reduce the carrying value of the artwork to management's estimate of realizable value. In addition, if the estimated realizable value of the art pledged as collateral for Finance segment loans is less than the corresponding loan balance, management assesses whether it is necessary to record a loss to reduce the carrying value of the loan, after taking into account the ability of the borrower to repay any shortfall between the value of the collateral and the amount of the loan. These factors may cause significant variability in Sotheby's financial results from period to period.

Sotheby's could be exposed to losses in the event of title or authenticity claims arising from sales or auctions of works of art.

The assessment of works of art offered for sale or auction can involve potential claims regarding title and authenticity. Items sold by Sotheby's may be subject to statutory warranties as to title and to a limited guarantee as to authenticity under the Conditions of Sale and Terms of Guarantee that are published in Sotheby's auction sale catalogues. The authentication of works of art is based on scholarship and research, but necessarily requires a degree of judgment from Sotheby's art experts. In the event of a title or authenticity claim against Sotheby's, Sotheby's may have recourse against the seller of the property and may have the benefit of insurance, but a claim could nevertheless expose Sotheby's to losses and to reputational risk.

Auction guarantees create the risk of loss resulting from the potential inaccurate valuation of art.

As discussed above, the art market is not a highly liquid trading market and, as a result, the valuation of art is inherently subjective. Accordingly, Sotheby's is at risk with respect to management's ability to estimate the likely selling prices of works of art offered with auction guarantees. If management's judgments about the likely selling prices of works of art offered with auction guarantees prove to be inaccurate, there could be a significant adverse impact on Sotheby's results of operations, financial condition and liquidity.

Sotheby's could be exposed to losses in the event of nonperformance by its counterparties in auction guarantee risk and reward sharing arrangements.

In certain situations, Sotheby's reduces its financial exposure under auction guarantees through risk and reward sharing arrangements. Sotheby's counterparties to these risk and reward sharing arrangements are typically major international art dealers or major art collectors. Sotheby's could be exposed to losses in the event any of these counterparties do not perform according to the terms of these arrangements.

Sotheby's Convertible Notes have early conversion features that, if triggered, could reduce its liquidity in the short-term.

Sotheby's 3.125% Convertible Notes have a stated maturity date of June 15, 2013, but may be exercised during any fiscal quarter if the closing price of Sotheby's Common Stock exceeds \$44.20 per share (i.e., 130% of the conversion price of the Convertible Notes) for at least 20 trading days in the period of 30 consecutive trading days at the end of the previous quarter (the Stock Price Trigger). It is Sotheby's current intent and policy to settle up to the principal amount of the Convertible Notes in cash. The Stock Price Trigger was not met during the second quarter of 2011 and, as a result, the Convertible Notes will not be convertible for the fiscal quarter beginning on July 1, 2011 and ending on September 30, 2011. However, if the Convertible Notes were to become exercisable during any fiscal quarter subsequent to September 30, 2011, and if any holders of the Convertible Notes elected to exercise during such periods, Sotheby's liquidity would be reduced.

Future costs and obligations related to the Sotheby's U.K. Pension Plan are dependent on unpredictable factors, which may cause significant variability in employee benefit costs.

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Future costs and obligations related to Sotheby's defined benefit pension plan in the U.K. are heavily influenced by changes in interest rates, investment performance in the debt and equity markets and actuarial assumptions, each of which are unpredictable and may cause significant variability in Sotheby's employee benefit costs.

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Tax matters may cause significant variability in Sotheby's financial results.

Sotheby's operates in many tax jurisdictions throughout the world and the provision for income taxes involves a significant amount of management judgment regarding interpretation of relevant facts and laws in the jurisdictions in which Sotheby's operates. Sotheby's effective income tax rate can vary significantly between periods due to a number of complex factors including, but not limited to: (i) future changes in applicable laws; (ii) projected levels of taxable income; (iii) pre-tax income being lower than anticipated in countries with lower statutory rates or higher than anticipated in countries with higher statutory rates; (iv) increases to valuation allowances recorded against deferred tax assets; (v) tax audits conducted by various tax authorities; (vi) adjustments to income taxes upon finalization of income tax returns; (vii) the ability to claim foreign tax credits; (viii) the repatriation of non-U.S. earnings for which Sotheby's has not previously provided for income taxes; and (ix) tax planning.

Sotheby's clients reside in various tax jurisdictions throughout the world. To the extent that there are changes to tax laws or tax reporting obligations in any of these jurisdictions, such changes could adversely impact the ability and/or willingness of clients to purchase or sell works of art through Sotheby's.

Insurance coverage for artwork may become more difficult to obtain, exposing Sotheby's to losses for artwork in Sotheby's possession.

Sotheby's maintains insurance coverage for the works of art it owns and for works of art consigned to it by its clients, which are stored at Sotheby's facilities around the world. An inability to adequately insure such works of art due to limited capacity of the global art insurance market in the future could have an adverse impact on Sotheby's business.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

(i) On July 7, 2011, the Company filed a current report on Form 8-K under Item 5.02, Departures of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers and Item 9.01, Financial Statements and Exhibits.

(ii) On August 8, 2011, the Company filed a current report on Form 8-K under Item 2.02, Results of Operations and Financial Condition and Item 9.01, Financial Statements and Exhibits.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SOTHEBY S

By: /s/ KEVIN M. DELANEY
Kevin M. Delaney
Senior Vice President,
Controller and Chief
Accounting Officer

Date: November 8, 2011

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Exhibit Index

| Exhibit No. | Description |
|------------------------|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
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