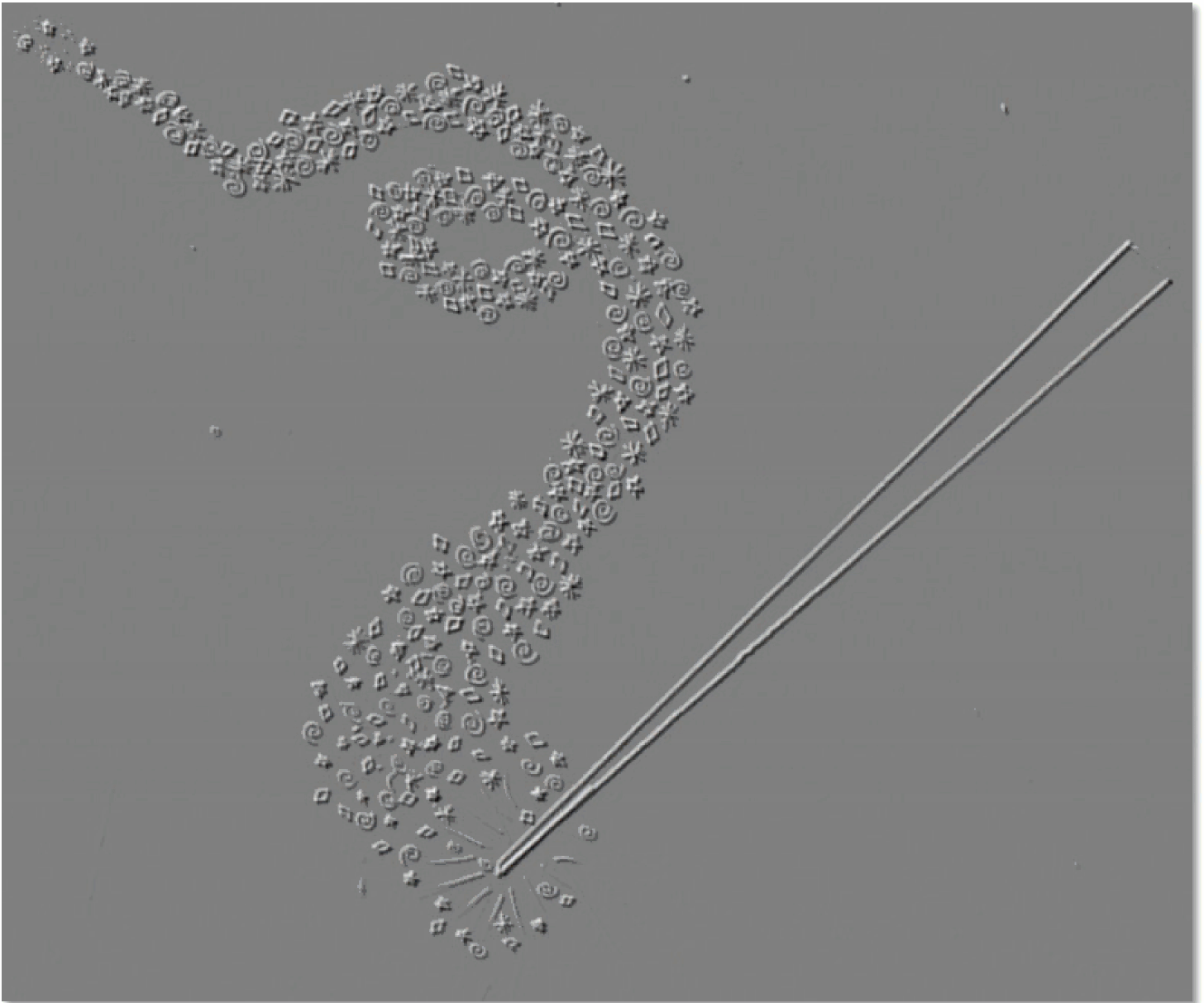
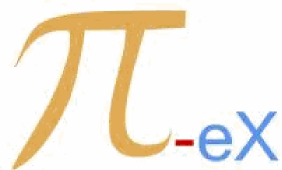


Guarantees and Irrevocable Bids



"Magic Wands" by Margot Tchelikidi

The Fine Art Market's Magic Tools?



EXECUTIVE SUMMARY:

After almost disappearing in 2009, guarantees at Impressionist and Contemporary Evening Auction Sales in London and New York returned in strength from 2010 onwards supported this time by Irrevocable Bids (IRBs). By 2017, more than 40% of the value of lots auctioned at the London and New York evening sales (based on the Low Estimates of auctioned lots) was covered by guarantees with almost 90% of these guarantees backed by Irrevocable Bids (see further information at the end for Pi-eX's data analysis methodology and dataset).

The growth in the number of Irrevocable Bids can easily be explained by the fact that Irrevocable Bids appear to be a magic tool for both the Sellers and the Auction Houses. By pre-selling the work to an interested party (the Third Party Guarantor) ahead of the auction, the risk of a no sale or bought-in - which is the principal risk for both the Auction House and seller - completely disappears.

For Third Party Guarantors and artwork buyers, Irrevocable Bids have been an evolving tool. Pi-eX's analysis of the last eleven years of evening auction sales in London and New York suggests that, while initially lots with Irrevocable Bids outperformed lots without guarantees, in recent years the positive volatility of Irrevocable Bids has been diminishing and that, since 2013, lots with Irrevocable Bids have performed more poorly than lots without guarantees.

This has been good news for those Third Party Guarantors who truly wished to acquire the lots to which they had committed Irrevocable Bids. The combination of lower positive volatility between the Low Estimate and the Hammer Price united with the discount the guarantors obtained from the Auction House as a Third Party Guarantor likely allowed them to acquire artworks at a preferential price as long as the price at which they initially committed to buy the artwork was not inflated. This may not, however, have been such good news for Third Party Guarantors who were counting on there being a spread between the Hammer Price and the Low Estimate in order to obtain a return via the percentage of the "overage" which the Auction Houses share with the Third Party Guarantors. If the spread was too low, or worse if no one overbid at the auction, the investment strategy of such Third Party Guarantors did not likely work as planned.

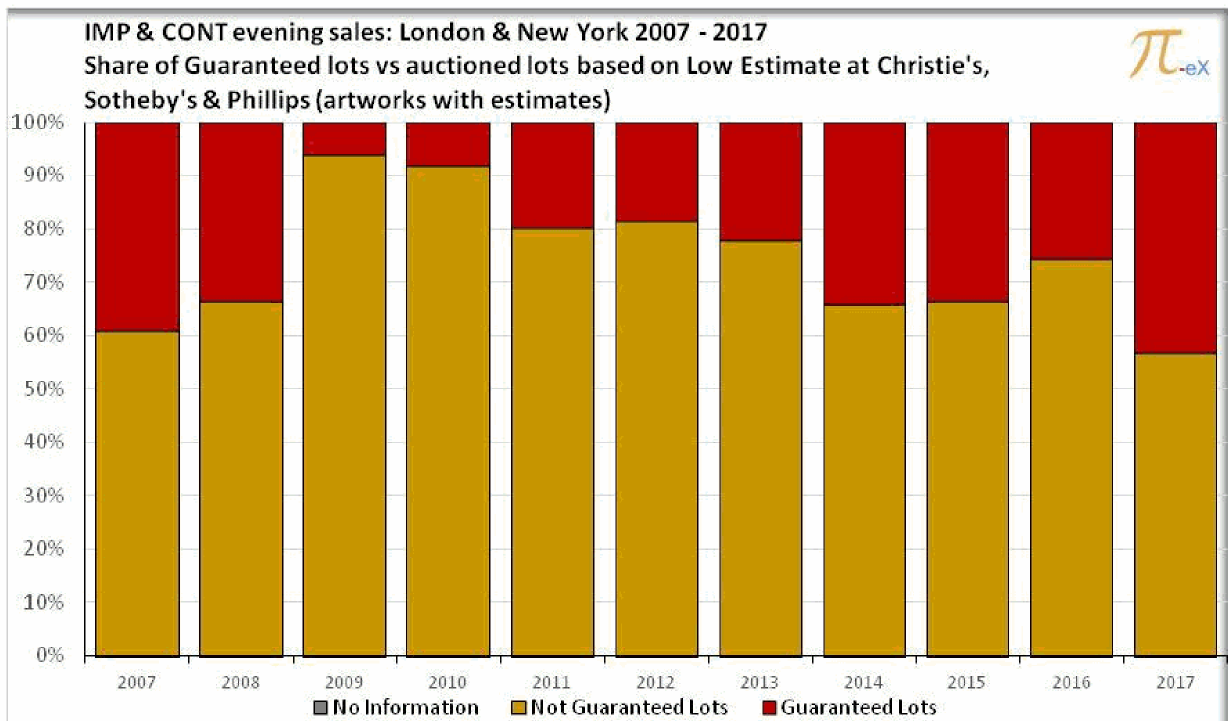
INTRODUCTION:

2017 saw the highest ever number of guarantees proffered at fine art auctions. Guarantees tend to be offered by the Auction Houses to potential sellers of Works of Art as a tool to convince them to consign their pieces for sale at auction. Once a guarantee is confirmed, the seller obtains a pre-agreed price for the consigned work. The Auction House then bears the full risk of a lower Hammer Price.

Such guarantees had been very popular in 2007. Guarantees, however, all but disappeared after 2008 as the Auction Houses once again realized that guarantees were not just simple marketing tools but also came with a heavy financial liability. In recent years, guarantees have returned but with a twist. Rather than keeping the risk in house, the Auction Houses now find a Third Party Guarantor (TPG) ahead of the sale. A Third Party Guarantor is a party interested in the guaranteed lot who commits before the auction takes place to purchase the lot at a pre-agreed price. The Third Party Guarantor pledges to raise its paddle until the pre-agreed price with the Auction House has been reached. Should the Third Party Guarantor's bid be matched, the Third Party Guarantor is then released from its commitment and will be financially compensated with a percentage of the upside between the final Hammer Price and the pre-agreed price. If no one matches the Third Party Guarantor's bid, then the Third Party Guarantor is obligated to buy the work at the pre-agreed price. If the Third Party Guarantor continues to bid above the pre-agreed price and ends up making the winning bid, the Third Party Guarantor can then buy the artwork at a discount as the price paid by the Third Party Guarantor is likely the Hammer Price less the already agreed financial compensation and the related buyer's premium.

1. 2017 saw the highest level of guarantees offered at evening sales in London and New York

More than 40% of the value of the lots offered at the Impressionist and Contemporary Evening Sales in London and New York (based on the Low Estimates listed in the catalogues) was covered by guarantee in 2017. This is more than the value covered in 2007 which, previously, had held the record for the greatest use of guarantees:



Overall, there has been a yearly decrease in the number of lots without guarantees from almost 1,400 lots in 2007 to less than 800 in 2017:



Source: Pi-eX Ltd proprietary database of auction results

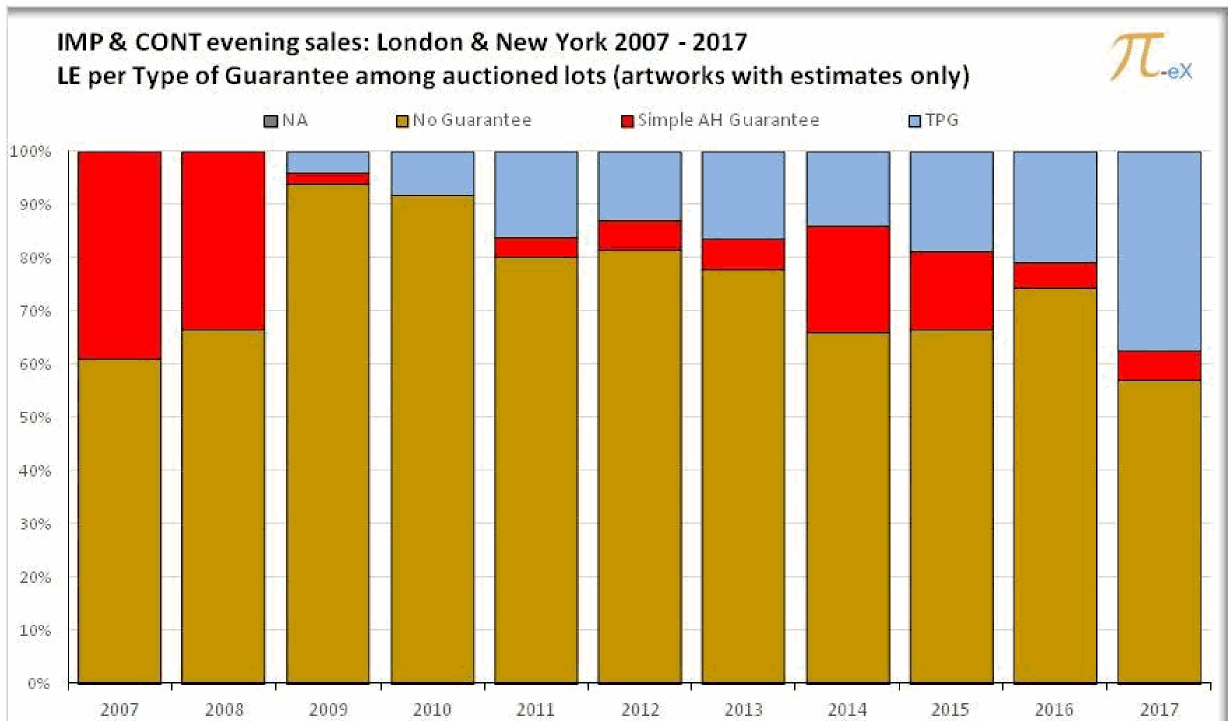
Meanwhile, the number of lots with guarantees reached its 2007 level back in 2017 after falling sharply in 2009:



Source: Pi-eX Ltd proprietary database of auction results

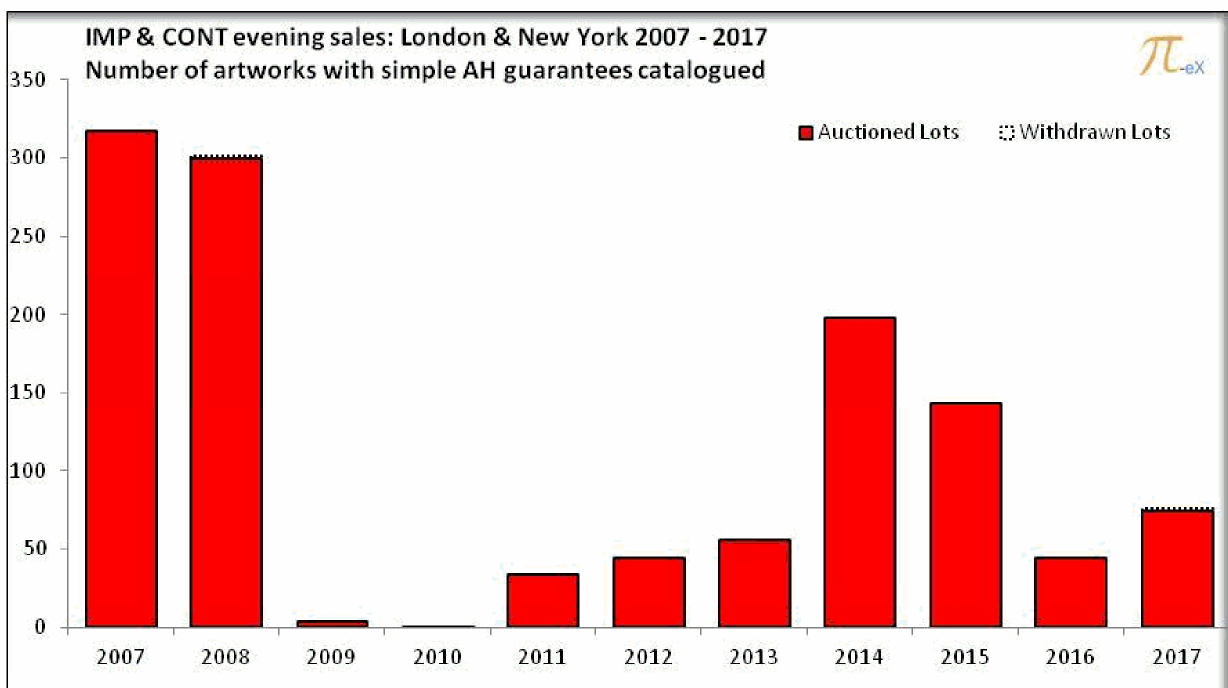
2. The great majority of the 2017 guarantees were backed by Third Party Guarantors:

Unlike the 2007 guarantees, most of the recently proffered guarantees were combined with Irrevocable Bids. This meant that the Auction Houses, rather than keeping the risk in house, passed the risk onto Third Party Guarantors via Irrevocable Bids:



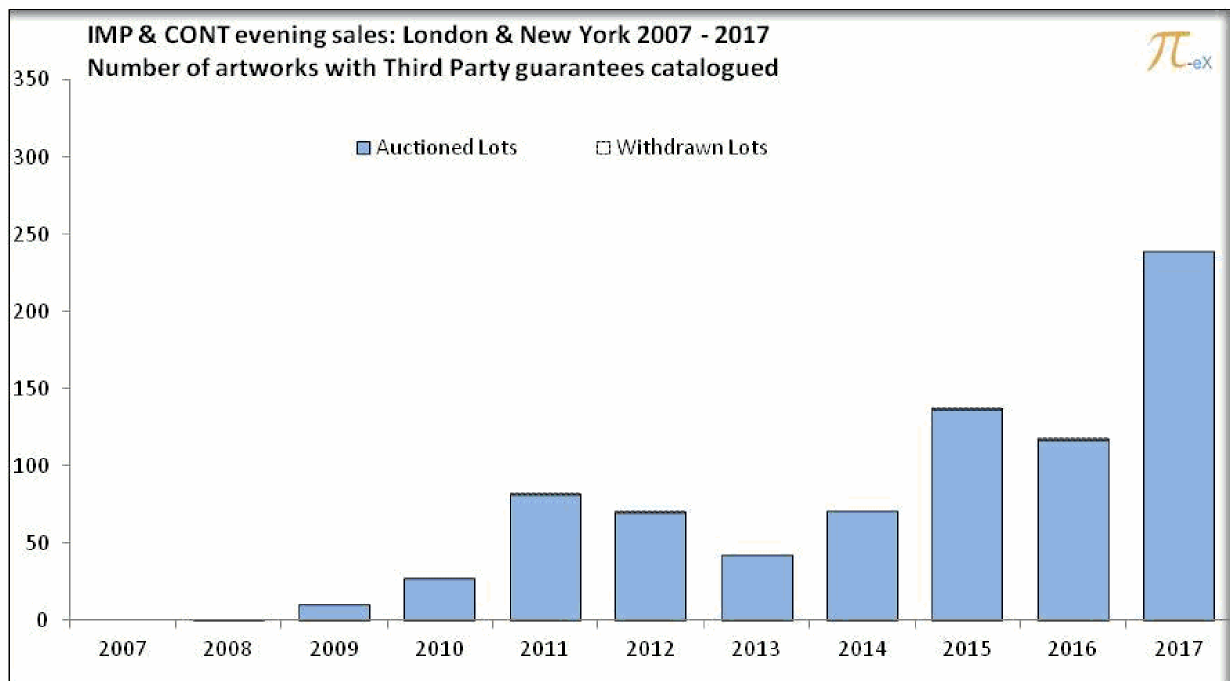
Source: Pi-eX Ltd proprietary database of auction results

After a sharp decline in 2009, the number of lots with simple Auction House guarantees started to grow again until 2014 but then the trend reversed.



Source: Pi-eX Ltd proprietary database of auction results

At the same time, the number of lots covered by Irrevocable Bids has continually increased:



Source: Pi-eX Ltd proprietary database of auction results

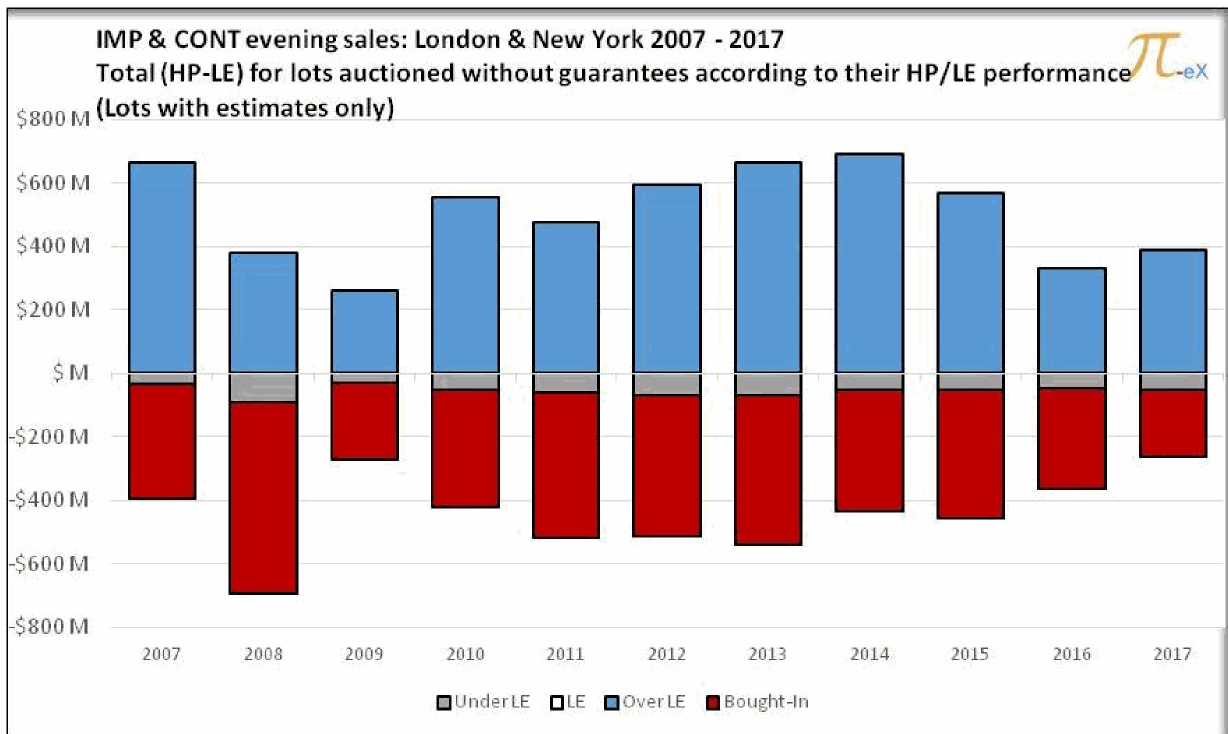
3. Irrevocable Bids are a magic tool for sellers and Auction Houses as they eliminate the risk of a no sale / bought-in:

The failure to find a buyer for an artwork at auction is the worst outcome for both the seller and Auction House. Historic analysis over the past eleven years shows that this risk is real for lots without guarantees and lots with simple Auction House guarantees. This risk, however, obviously, completely disappears for lots with Irrevocable Bids.

In the following charts, Pi-eX's analysis shows the outperformance (Hammer Price minus Low Estimate) of lots that sold above their Low Estimate (in blue) against the underperformance of lots sold below their Low Estimate (in grey) and the dramatic underperformance of lots that were bought in (in red). Obviously lots that performed exactly at their Low Estimate (when the Hammer Price equals the Low Estimate) do not appear on the graphs as the performance would have been zero. By comparing the performances of lots without guarantees to lots with simple Auction House guarantees and lots with Irrevocable Bids, some very interesting observations on volatility can be made:

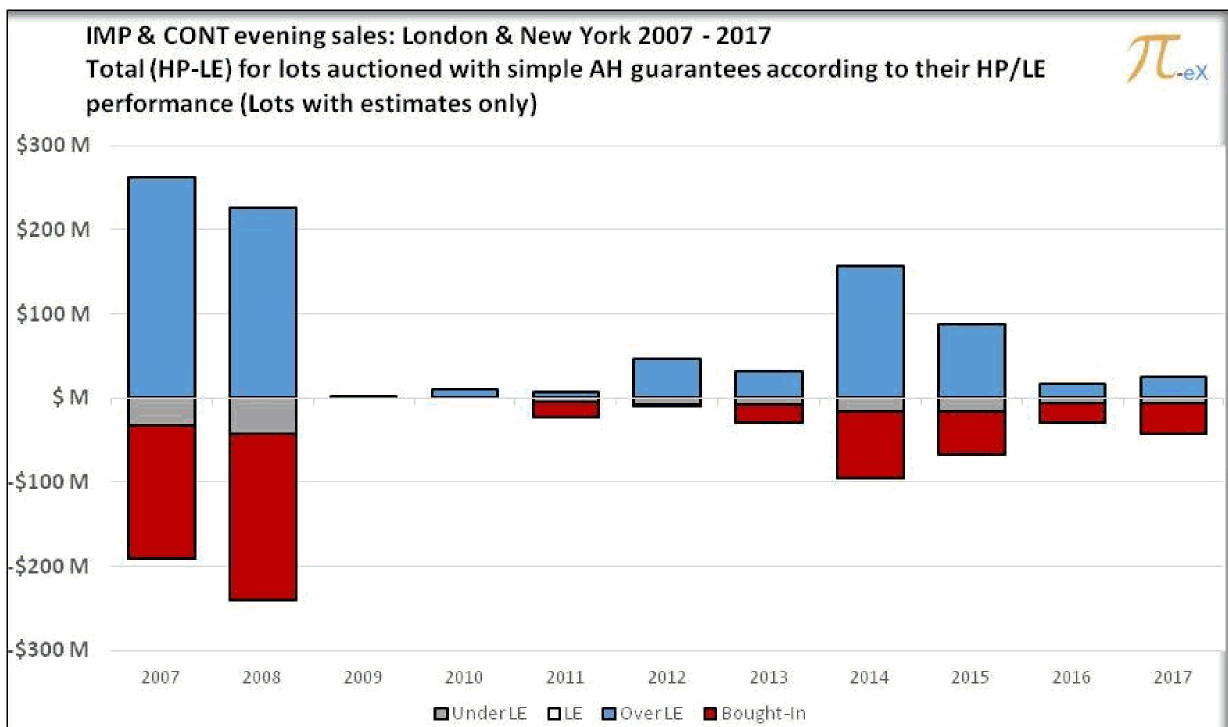
Historic volatility of lots without guarantees:

Lots without guarantees have, historically, demonstrated significant positive and negative volatility. Some lots have performed extremely well, others extremely badly. This is shown clearly in the following graph which features the cumulative difference between the Hammer Price and the Low Estimate based on the performance of the lot's Hammer price versus the original estimate ahead of the auction. The best positive volatility occurred in 2007 and 2014, the worst negative volatility in 2008.



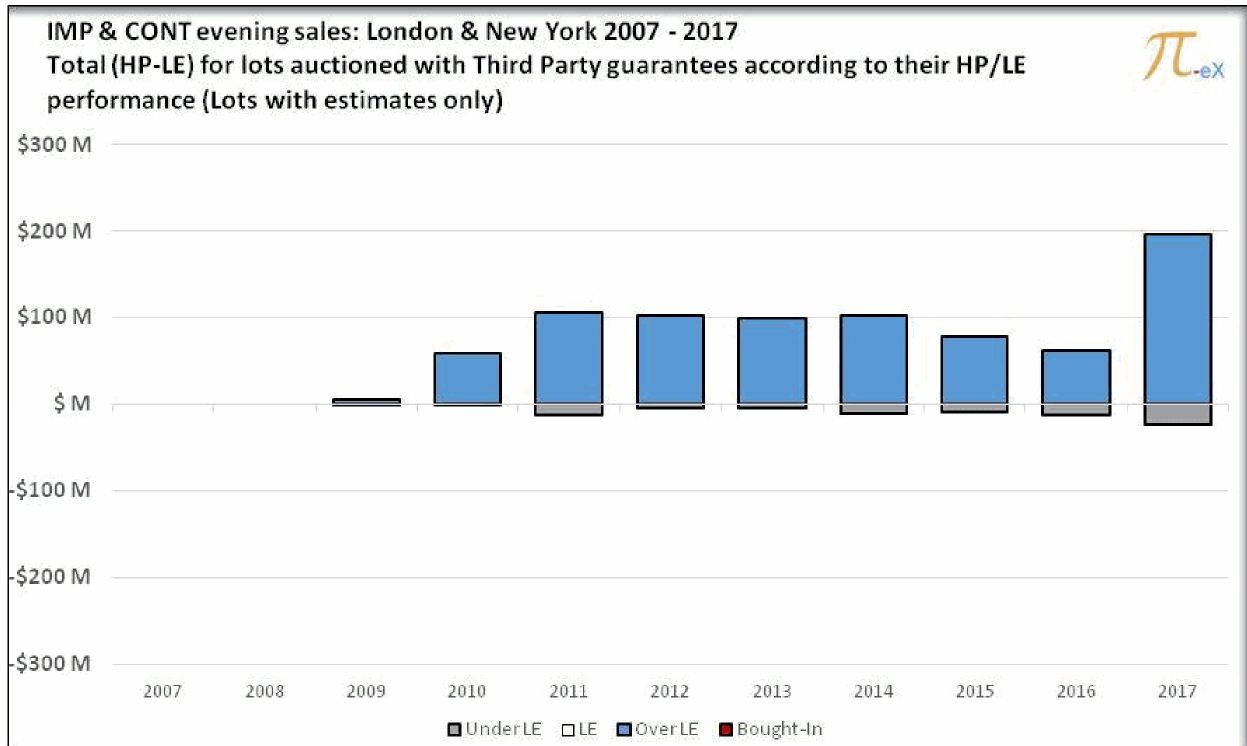
Historic volatility of lots with simple Auction House guarantees:

Lots with simple Auction House guarantees demonstrate similar volatility. This was especially the case in 2007 and 2008. As a result, the Auction Houses reduced the number of simple Auction House guarantees. This was clearly an effort to protect themselves from the inherent volatility of the auction process.



The one way volatility of Irrevocable Bids:

By definition, Irrevocable Bids cannot be bought-in since they include a pre-auction agreement that forces a Third Party Guarantor to buy the artwork at auction. This means that negative price volatility is absent. The historic data, however, demonstrates that there has been positive volatility. Lots with Irrevocable Bids, on average, have achieved Hammer Prices above the Low Estimates listed in the catalogue. Overtime however negative volatility seems to be increasing as more lots sold for less than their Low Estimates in 2017.



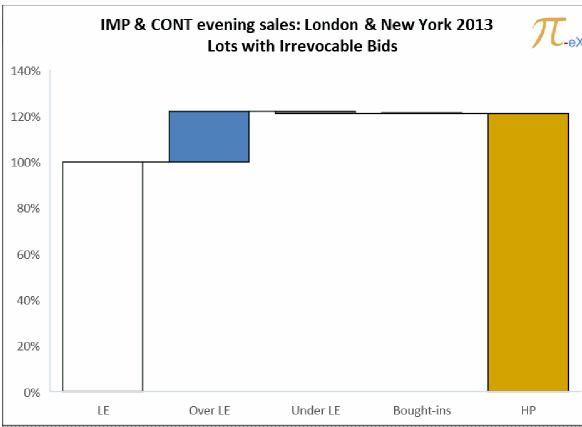
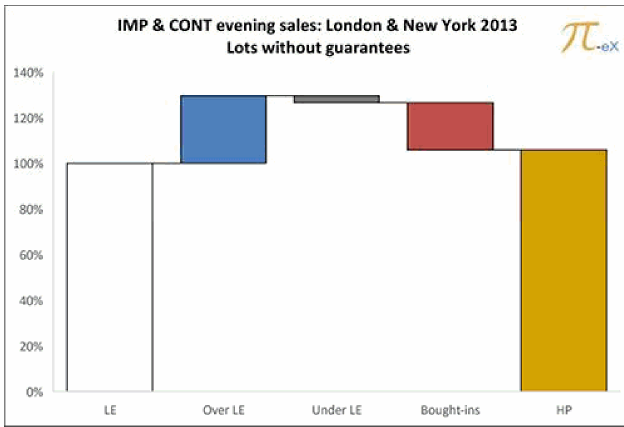
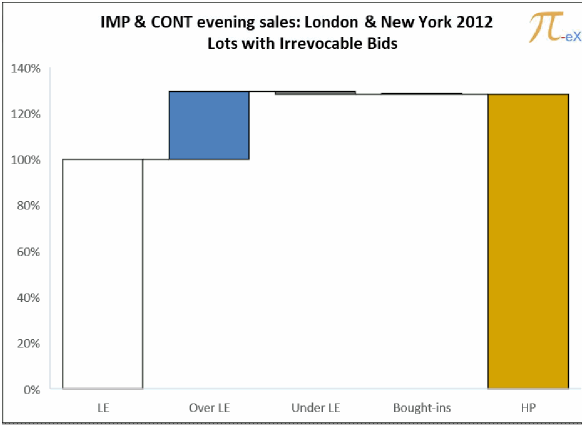
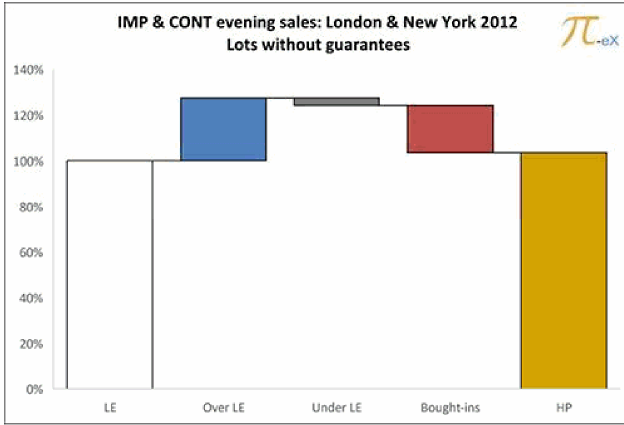
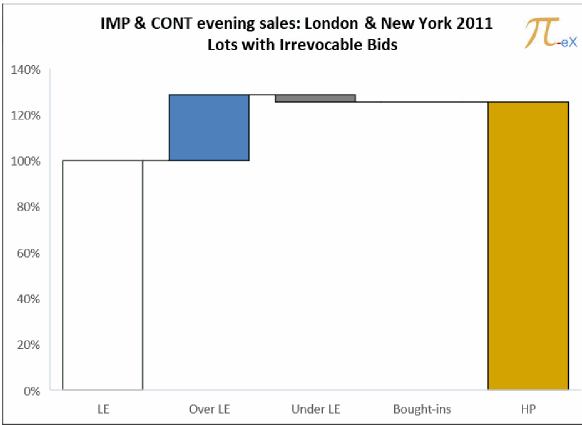
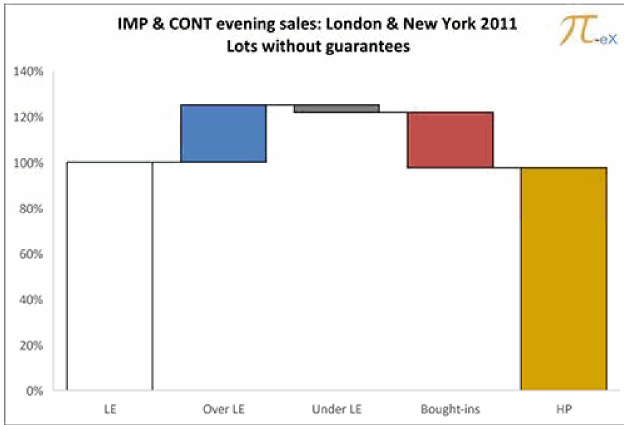
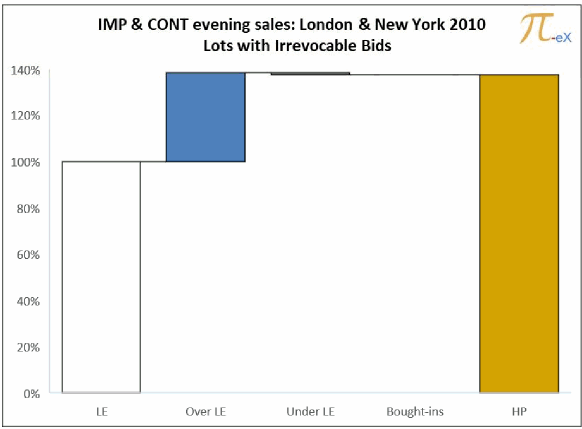
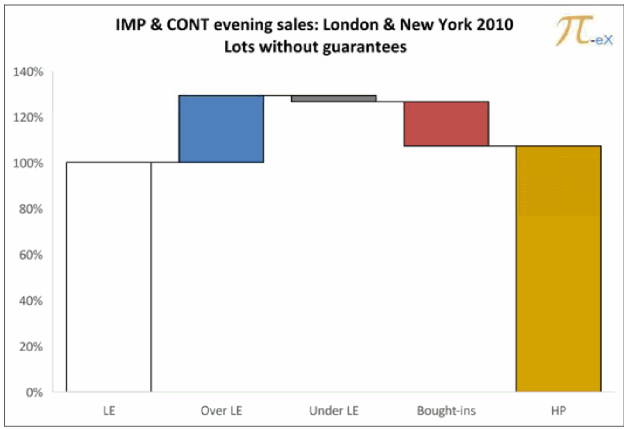
Source: Pi-eX Ltd proprietary database of auction results

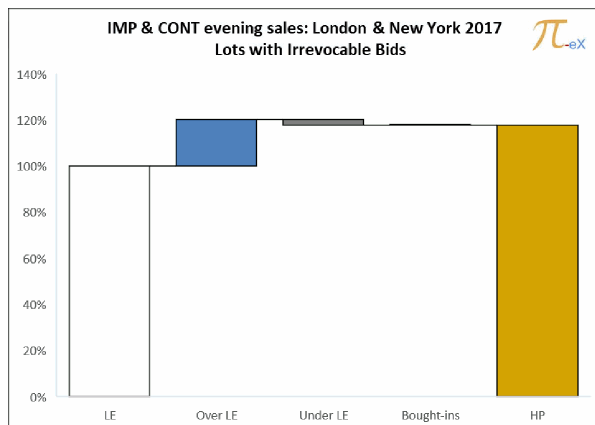
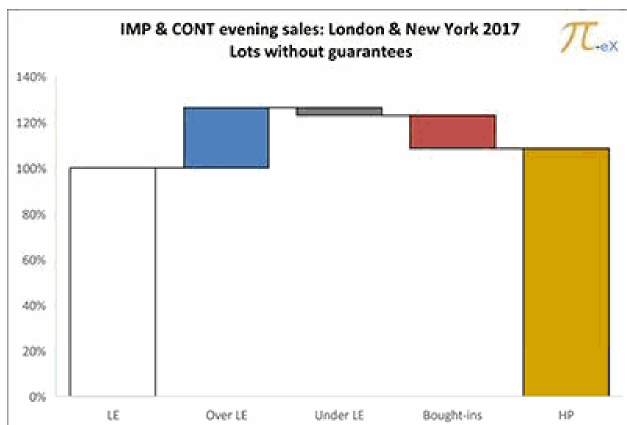
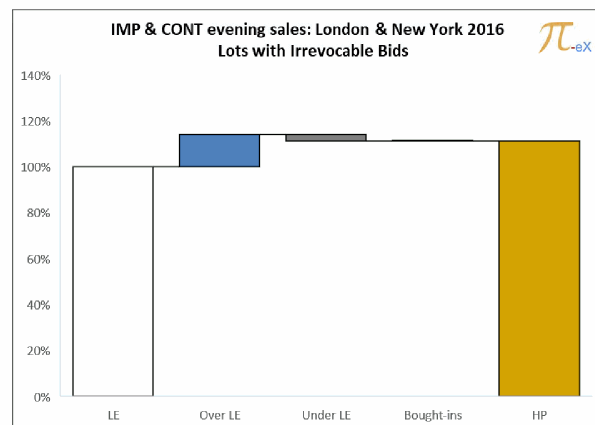
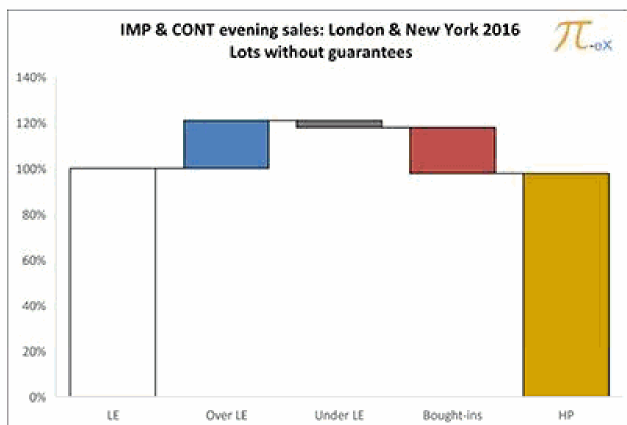
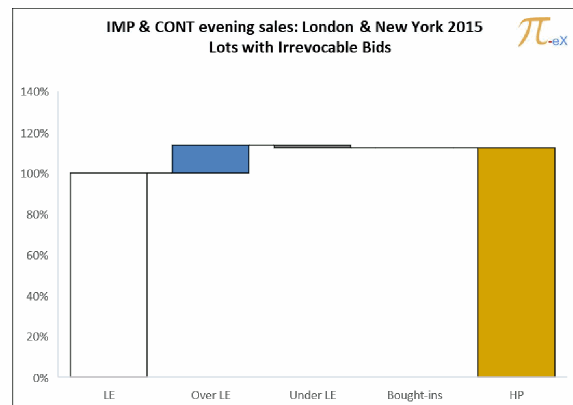
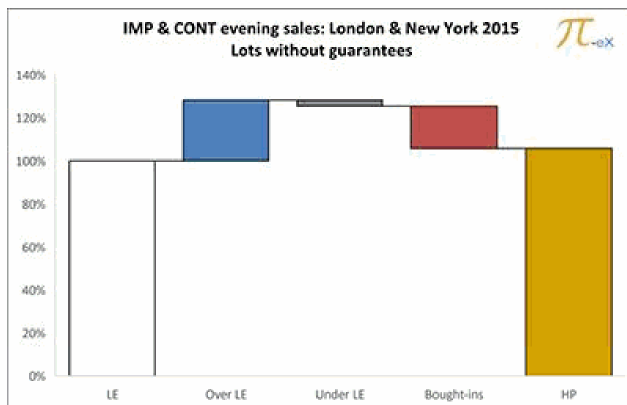
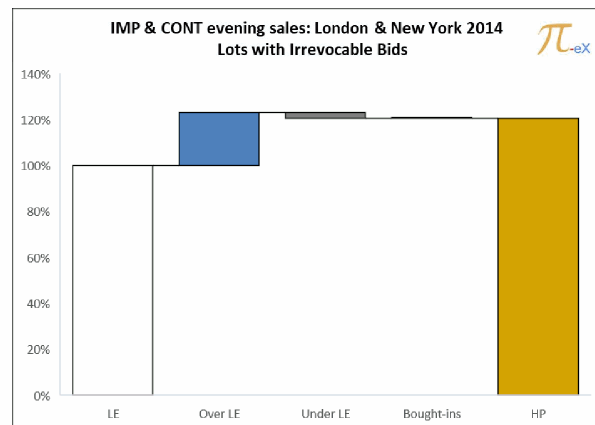
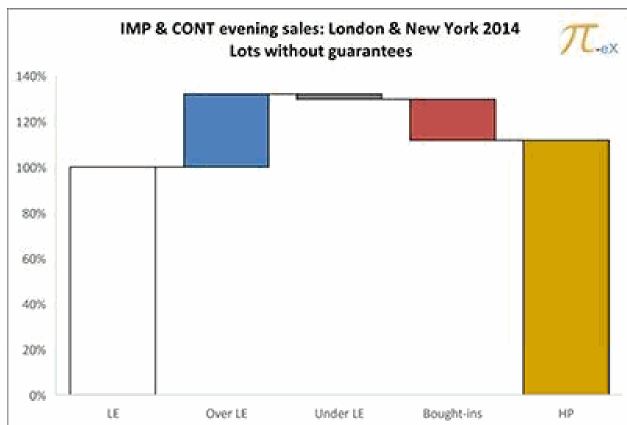
4. The performance of Irrevocable Bids has evolved overtime:

For Third Party Guarantors, whether they are collectors wanting to acquire artworks or investors looking to obtain a return on their investment in the fine art market, the end game for an Irrevocable Bid resides in the spread between the price at which the Guarantor commits to buy the artwork and the final price obtained at auction. While specific prices for Irrevocable Bids are unique for each deal and confidential, it is reasonable to believe that the Low Estimate is likely representative of the price guaranteed by the Irrevocable Bid. Pi-eX therefore takes the Low Estimate for the artwork and compares it to the Hammer Price.

The following analysis compares the performance of Lots with guarantees with Lots with Irrevocable Bids over the last seven years. In 2010, Irrevocable Bids, commanded, overall, a wide positive spread above the original Low Estimate. Since then, the spread has slowly but surely narrowed. Since 2013, lots without guarantees have, overall, realized a greater positive volatility than lots with Irrevocable Bids.

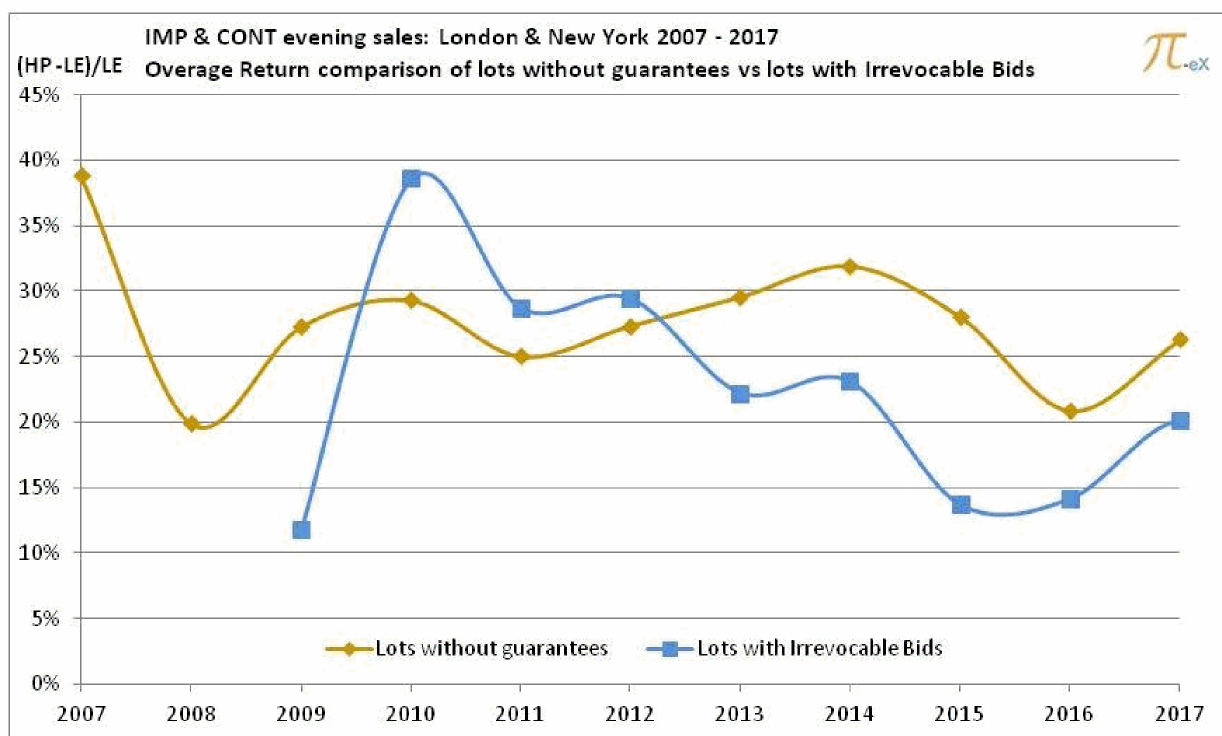
2010 – 2017 Performance of lots without guarantees versus Lots with Irrevocable Bids





Source: Pi-eX Ltd proprietary database of auction results

This is confirmed by mapping the positive spread over the Low Estimate as a percentage of the same Low Estimate. While the spread for lots with Irrevocable Bids was above the spread for lots without guarantees from 2010 to 2012, since 2013, lots without guarantees that sold for Hammer Prices above their Low Estimates have performed better than lots with Irrevocable Bids.



As 2018 has, so far, shown no signs of a slowdown in the number of Third Party Guarantors, it will be interesting to see how this year's lots with Irrevocable Bids perform versus lots without guarantees.

CONCLUSION:

Irrevocable Bids were introduced by Auction Houses as a way to limit their financial risk when offering a guarantee to sellers. Such Irrevocable Bids have performed very well for Auction Houses and sellers as they have allowed the former to 1) offer more guarantees to the latter without taking as much risk while 2) making the results of auctions more predictable by eliminating the risk of bought-ins.

Irrevocable Bids have also been very popular among buyers and investors. Third Party Guarantors have seen an opportunity either to gain a privileged position at the auction of a desired work of art or to earn a return on their investment without even having to buy the work of art. The persistent narrowing of the spread between the Hammer Price achieved and the Low Estimate may, however reduce returns for such financial investors. This suggests that, increasingly, the Irrevocable Bid Model may be more attractive for collectors who truly intend to buy the artwork as the narrower spread and shared overage would give such collectors the opportunity to buy artworks at bargain prices.

But what would happen then, were all potential buyers to decide to become Third Party Guarantors before placing bids at auction?

METHODOLOGY:

1. DATA SET:

Pi-eX included in its study all repeating Impressionist and Contemporary Evening Sales in London and New York from 2007 to 2017 at Christie's, Sotheby's and Phillips. Private collections and curated sales which occurred on the same day or around the above mentioned sales were not included in the data sets examined.

Pi-eX's analysis covers 250 evening auction sales, 140 in London and 110 in New York, 88 Impressionist and 162 Contemporary, 98 auction sales at Christie's, 98 at Sotheby's and 54 at Phillips.

Lots wise, the analysis encompasses 14,201 lots, 7,555 lots catalogued in London versus 6,646 in New York, 4,957 lots catalogued at Impressionist Evening Sales versus 9,244 lots at Contemporary Evening Sales, 5,919 lots catalogued at Christie's, 5,688 lots at Sotheby's and 2,594 lots at Phillips.

2. DATA CLEANING:

The original data sources for all the auction results were the websites of each of the Auction Houses. Pi-eX then cross-checked the Auction Houses' website recorded data against data from Blouin and/or Artnet and alongside the lot details recorded in the Auction Houses' original paper catalogues. This process suggested that the results now recorded on the Auction Houses' websites omit as many as 1,490 of the original lots catalogued but not sold (about 10% of the total number of lots catalogued from 2007 to 2017). Within its dataset, Pi-eX is confident that it has re-instated all the withdrawn and bought-in lots missing online. After completion of the data research and cleaning, Pi-eX's expanded dataset only fails to specify the guarantee status of a few lots. This amounts to only 17 lots or about 0.001% of the total dataset.

3. DATA FORMATING:

Given that the auction sales took place in two different cities and that results were priced in differing currencies, GBP and US\$, Pi-eX converted all the GBP results into US\$ based on the then prevailing daily Bank of England exchange rate.

4. DEFINITIONS:

- **Catalogued Lots:**
Catalogued lots are lots listed in the paper catalogues published by the Auction Houses ahead of the auction.
- **Auctioned Lots:**
Auctioned lots are lots that are offered for sale on the night of the auction.
- **Bought-in Lots:**
Bought-in lots are lots that failed to sell at the auction. While there may have been some interest in the lot, the highest price achieved did not reach the reserve price set by the artwork seller. The lot was

therefore named “a pass” by the auctioneer.

- **Sold Lots:**
Sold lots are lots that were sold at the auction.
- **Guaranteed lots:**
Guaranteed lots are all lots for which the seller was offered a guarantee by the Auction House. These lots can have either of the following status.
- **Lots with a simple Auction House Guarantee:**
Lots with a simple Auction House Guarantee are lots for which the Auction House has offered a guarantee to the seller and retained the risk in-house. This means that there is no Third Party guarantor involved in the sale process.
- **Lots with Irrevocable Bid (IRB):**
Lots with Irrevocable Bids are lots for which – after guaranteeing the lot to the artwork seller - the Auction House then found a Third Party Guarantor (TPG) who committed to buy the lot at a pre-agreed price ahead of the auction.
- **Third Party Guarantor (TPG):**
Lots with Irrevocable Bids.
- **Low Estimate (LE):**
Low Estimate is the lower estimate published in the Auction House’s catalogue for a specific lot ahead of an auction.
- **High Estimate (HE):**
High Estimate is the higher estimate published in the Auction House’s catalogue for a specific lot ahead of an auction.
- **Hammer Price (HP):**
Hammer Price is the price obtained for a lot at an auction. It does not include the Auction House’s Buyer’s Premium nor other potential taxes.
- **Reserve Price (RP):**
Price below which the seller of the artwork would not sell the work. The Reserve Price is agreed between the seller and the Auction House ahead of the auction.
- **Buyer Premium (BP):**
Commission charged by the Auction House to the buyer. The Buyer Premium is based on the Hammer Price obtained by the lot at an auction.
- **Over LE:**
Lots that obtained a Hammer Price above their Low Estimate.

- **LE:**
Lots that obtained a Hammer Price equal to their Low Estimate.
- **Under LE:**
Lots that obtained a Hammer Price below their Low Estimate.
- **Bought-in:**
Lots that obtained a Hammer Price below the seller's reserve price and thus failed to sell.

About the Author:



Christine Bourron is the founder & CEO of Pi-eX Ltd.

Pi-eX's is a UK based, FCA authorized, Financial Broker Dealer. The company's mission is to provide analytical and financial tools that help investors and art stakeholders better understand and manage risk and volatility in the fine art market. Over the past four years, the company built up a proprietary database of auction sales results at the top three Auction Houses: Christie's, Sotheby's and Phillips.

It also developed a unique Behavioral based fine art data analysis methodology, for which it was shortlisted as a finalist at the 2017 Financial Innovation Awards, presented by The London Institute of Banking & Finance and UK Finance.

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