

Skate's Art Market Research

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Skate's Art Investment Review

Global Art Industry: Annual Report for 2011 and Outlook for 2012
Sections 1-2

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SECTIONS DETAILING 2011 STATISTICS ON THE ART MARKET, SKATE'S ART STOCK INDEX AND
SKATE'S TOP 5000 CHANGES TO BE PUBLISHED NEXT WEEK

The Art Market Will Decompose Into Investment and Consumer Grades Art Securitization and e-Commerce to Drive Growth for These Market Segments, Respectively

1. *The Big Picture: Art Market Drivers—From Art as an Investment to Art as a Consumer Good*

The concept of art as an investment has emerged from something viewed as vulgar and inappropriate less than ten years ago to the mantra of the art trade today. It is a concept that has helped to drum up demand for works in the midst of economic turmoil and garner the attention of new buyers, thus expanding the addressable market for art dealers and auction houses.

When we founded Skate's in 2004 and began talking about effective investment returns on works of art, using financial terms such as "free float", "peer group valuation" and "value enhancement" in conjunction with art, art trade practitioners were often at a loss. Now, seven years later, we have a good several thousand of them as subscribers and enjoy close relationships with many professional art organizations and businesses that have come to embrace the investment approach to art buying and selling. The idea of art as an investment has become embedded in their thinking.

As recently as 2009 when [Skate's Art Investment Handbook](#) was published, even the well-known name of the book's publisher—McGraw-Hill—was not enough to get the book into U.S. museum stores, which maintained a ban on all art investment literature. Throughout 2011, however, we have seen the diffusion of "art as an investment" school of thought from the fringes of the finance world into the mainstream view of what drives art purchases and sales in an increasingly broad global art marketplace. Fuelled by global

economic uncertainty, investors, lured by its asset protection quality, have poured capital into fine art. The rapid growth and globalization of art market participants have clearly moved buy-side power to new money that is interested in no-nonsense discussions of risk and return, transaction transparency and ownership costs, as well as other core aspects of art as investment thinking. Access, social cache, personal tastes, the electric magic of the auction room and the dealer's pitch are things that remain in play as factors related to art buying. Yet these factors are no longer isolated from hard facts and financial numbers.

We have long preached the advent of rational thinking about art as an alternative investment class, being used not to substitute but to compliment traditional art buying practices. It has now arrived. Now what?

Skate's believes that this arrival marks not the end but rather the beginning of a long and profound change that will sweep the art market in the coming decade. It will follow two distinct trends: segregation of the investment quality art market and the rapid transformation of a cottage art trade industry into an increasingly efficient corporate structure, with supply chain management and a retail system more efficiently linking artists and consumers.

Segregation of the Investment Quality Art Market

In 2011 alone Skate's estimates that there were over 2,000 transactions completed on the auction market involving artworks priced at \$1 million or more per work. There were probably as many deals completed in galleries and art fairs around the world as well. Art trading volumes have grown close to \$80 billion for 2011, having reached peak levels previously seen in 2006-2007 (the honorable professor of art economics, Clare McAndrew, will publish her numbers and analysis in the TEFAF report next March, the macro bible for the art world).

No longer an anecdote, the multimillion dollar price tag for a work of art coupled with the increased austerity of public finances in the developed world, specifically funds available to maintain major public museums, makes it only a matter of time before the public consciousness will awaken to the fact that museums are no longer pillars of national culture and pride requiring government subsidies and private donors to survive. These institutions will instead be seen as government-owned treasuries that can help balance government deficits by using capital markets and modern finances to unlock the value of their vaults without necessarily selling significant volumes of art treasures ("de-accessioning" in museum terminology). Cash from capital markets can be used to finance museum budget deficits.

Closely watching capital flows from the technology world and emerging market riches into art, Skate's believes that the art market will become saturated at a trading volume below \$100 billion per annum with no massive new capital inflows to be seen

into art from the world's high net worth individuals. In fact, following the long market bonanza caused by the end of the Cold War, the advent of global trade and the emergence of the BRICs, the global art market will land on the same plateau as it was immediately following the Japanese speculative buying spike in the 1980s.

The art funds of today give weak hope. While the numbers can vary, fewer than 100 art funds are open to outside investors globally. Furthermore, their art purchases do not even account for 1% of total art purchases worldwide. The London-based research firm ArtTactic, which is run by our respected competitor and friend Andres Patterson, believes that the money under management in the art funds industry grew by nearly 50% in 2011 to \$1 billion, although we see many of those funds as more reminiscent of certain individuals' structured art holdings than truly transparent collective investment vehicles. At Skate's we have managed to establish coverage of only a dozen art funds to date, most of which remain as secretive and as weakly transparent as the market they operate in. Unless a major change is forthcoming, this is not the way to grow a collective investment industry.

Yet change will come, and we expect it to come from museums. Investment banks have to make money, but museums must look for novel ways to fund their operating budget deficits in an era where Western public finances can only be considered a mess. It is only a matter of time before art securitization will fly in earnest. One only has to imagine a \$1-2 billion art fund based on a small part of a major museum art collection, widely supported by authorities as a government deficit-reducing initiative

and marketed as an asset protection investment product to retail investors worldwide. Although not a Zynga or Groupon IPO, it could still sell well and definitely have an enviable NAV and liquidation value.

The infrastructure is there; one only has to look at the art securitization experience of Russia's Fotoeffect or the UBS-structured Ancient Coins Fund for evidence. Once the pilot works, there would be an avalanche of museum-led securitizations expanding the art funds industry from \$1 billion to \$10 billion in a few years time. A clear preference is emerging for institutional dealing with big ticket artworks, as these bring reduced transaction and due diligence costs for the funds and their management companies.

The premium segment of the art market—which we benchmark with Skate's Top 5000 peer group of the world's most valuable works of art at auction prices with a current threshold price of \$2.136 million and a combined value (market cap) of \$30.5 billion—should clearly evolve into an investment market of its own. It will see significant liquidity improvement once museum-lead art securitizations materialize.

This segregation of the art market's premium segment is already clearly seen as more capital has been committed to pre-auction guarantees and art lending in 2011. This capital has mostly gone to support trades involving high value art, thereby reducing the relative cost of due diligence and other expenses (as in every proper financing deal, more or less the same amount of work goes into a deal regardless of its size). The availability of such guarantees and lending facilities contribute to the liquidity of the high value segment of

the art market, which helps to widen the gap between the market for well-established artists and their major works on the one hand, and less universally accepted artworks on the other.

Strategically, this trend would give a huge boost to the high-end auction market oligopoly of Sotheby's and Christie's. If they manage to recognize that soon, they may want to stimulate museum-led art securitizations before their "new money" driven growth of recent decade flattens out over the next few years.

Transforming Old Art Retail Habits into Modern Specialty Retail

As buying and selling art becomes less and less akin to entering a temple and hearing from the gods, the entire industry will have to reform to meet new consumer patterns. This situation is very much reminiscent of the shopping revolution in the 19th century when the arrival of the first department stores across France, the U.K. and the U.S. made shopping more democratic and led to greater consumption from more comfortable and hence more enthusiastic customers.

The art fair bazaars and convenience stores of today's galleries will have to evolve toward new age art shopping concepts in the same way that old markets and specialized stores transformed into department stores and retail chains. Incumbents, of course, will remain but their market share will diminish and they will have little ability to respond to changes in consumer habits and preferences.

New retail formats, including online ones, (for a detailed discussion of art e-commerce, please see section 2 of this report below),

focus on brands and cleverly managed choice. The introduction of efficient procurement, supply chain and inventory management practices supported by the ability to compete on scale and enjoy access to low-cost working capital will bring the global art trade to the masses of tomorrow in lieu of a nice gallery next door.

There is already a first mover in the space with Gagosian definitely heading in this direction. The branding requirement has already been met—Gagosian knows how to produce contemporary artists and use modern marketing techniques to his advantage. Procurement (a clever artist signing process, management of artist foundations and other tricks of the trade that contribute to success) and scale (international offices definitely resolve the issue of global distribution and sideline competing dealers) are also taken care of. Skate's expects that once Gagosian hits the very same plateau that we mention above

2. Art Market Migration to Online and Mobile Platforms

Given the core thesis above—that the art market will quickly develop along the lines of a new-age consumer product vertical with wide adoption of modern distribution, marketing and retailing practices in the coming years—the key to forecasting the art industry's evolution concerns how the incumbent art trade will embrace a consumerist approach to art and adopt best practices for electronic commerce.

Like figure skating, where athletes are rated separately for artistic and technical skills, Skate's has ranked art industry ventures for their artistic merit (the existing position in the global art industry in terms of overall volume and current e-commerce

for high-end art, the firm will refocus on pushing lower ticket art through its distribution channels, thus transforming most of its galleries into new age art department stores available to the masses. Succession planning (or lack thereof) is probably the only challenge that can kill the Gagosian first mover advantage as things stand today.

Other top notch galleries should follow this trend once they exhaust the benefits from their march to Asia and their quest for mysterious Russian or Arab buyers. They should look for a more systematic way of generating and growing trading volumes. High-end art trading will require less retail attention and more focus on the investment aspect, while steady volumes could be achieved through reformatting their product assortment (i.e., art) and store format to please crowds. A precondition thus exists for the art department store revolution to take place in the near future.

capabilities) and their technical merit (simply based on the art industry venture's rank in internet traffic to date). We begin with technical merit—just as any internet user would do—checking what art is being sold online and by whom. The following section outlines our findings.

Technical Merit

Technical merit should have been and indeed was easy to assess. We have used the widely adopted Alexa traffic measurement system to evaluate the existing traffic ranking of the websites operated by the world's art industry companies. We have excluded pure media organizations, such as the arts pages of The

New York Times, The Art Newspaper, Artinfo and our own humble site, instead considering only those sites that trade art online and/or offline or represent existing online and/or offline art marketplaces today. The technical merit ranking yielded some rather interesting results, which are shown in Exhibit 1 below.

The most important takeaway from this assessment is that, like elsewhere in the global migration of retail trade online (with only food and art successfully resisting so far), the pure plays with a laser focus on online

retail are prevailing, while offline incumbents can fight back if they respond early.

eBay (the world’s sixth most widely used website) has a towering presence. Unlike Amazon (the world’s fifth most frequented site), which has yet to bother itself with arts and collectibles (“Arts, Crafts and Sewing” is the closest Amazon category to art and is hardly worth visiting), eBay has spent a considerable amount of time and money building an art e-commerce vertical for its customers.

Exhibit 1 – Skate’s Top 30 Art Industry e-Commerce Leaders, Technical Merit*

Rank	Site	Traffic Worldwide	Traffic in Local Country
1	eBay.com	20	6 (U.S.)
2	liveauctioneers.com	10,133	3,155 (U.S.)
3	artnet.com	11,152	5,412 (U.S.)
4	christies.com	11,771	5,867 (U.S.)
5	ha.com (Heritage Auctions)	19,436	4,962 (U.S.)
6	artprice.com	21,450	2,235 (France)
7	sothebys.com	24,363	20,421 (U.S.)
8	artifact.com	26,555	9,591 (U.S.)
9	saatchionline.com	30,682	21,460 (U.S.)
10	bonhams.com	43,883	25,168 (U.S.)
11	dorotheum.com	98,679	1,275 (Austria)
12	gagosian.com	109,112	69,345 (U.S.)
13	artbaselmiamibeach.com	113,473	16,364 (U.S.)
14	artnet.de	129,984	10,506 (Germany)
15	phillipsdeputy.com	138,780	89,545 (U.S.)
16	art.sy	177,752	54,185 (U.S.)
17	cguardian.com (China Guardian)	188,289	25,829 (China)
18	tajan.com	201,985	9,663 (France)
19	friezeartfair.com	231,721	78,300 (UK)
20	artbasel.com	251,816	49,671 (U.S.)
21	saffronart.com	265,409	40,234 (India)
22	igavelauctions.com	299,727	20,958 (California)
23	sedition.com	321,822	44,416 (UK)
24	polypm.com.cn (Poly Auction)	338,467	42,859 (China)
25	villa-grisebach.de	455,425	66,462 (Germany)
26	paddle8.com	459,417	108,814 (U.S.)
27	artprice.fr	672,105	26,622 (France)
28	welcometocompany.com	825,020	179,047 (U.S.)
29	heffel.com	831,797	14,204 (Canada)
30	vipartfair.com	1,068,563	n.a.

*Alexa rank as of December 18, 2011; Source: Skate’s, Alexa.com

Skate's has covered in detail how eBay got burned by its foray into the online art trade in 2000 with the scam related to Diebenkorn artworks followed by the termination of its partnership with Sotheby's (unrelated to the Diebenkorn scandal) that had been in place since 2002 (for more details, please see pg. 28 of [Skate's Art Investment Handbook](#)). Yet for all its misfortunes eBay still offers the best infrastructure for the online art and collectibles trade. As of today eBay has 38 market categories (including one called "Everything Else"). Of those, seven can be classified as arts and collectibles. While eBay does not disclose its financial results by category, the subgroup called "Collectibles and Art" is the fourth most important group for the company after fashion, motors and electronics. Technically speaking, there is no better place to trade art than on eBay.

However, there are two important obstacles, excluding the issue of security and policing for malpractices (such as wrong attribution) where eBay has significantly improved over the years. First, one eBay handicap is its inability to offer a fusion between online and offline trading that allows its users to see the art they want to purchase at predefined and visually appealing locations. As everyone in art trade knows, art buying is all about an impulse of physical contact and without one the eBay art marketplace will be overlooked by the majority of those who want to physically experience their art before acquiring it. Second, eBay does not curate its marketplace and is not aggregating information resources supporting art buying and selling decisions. Without those information aides, distilling artworks from

the avalanche of graphic imagery, eBay's art categories today bear more resemblance to a flea market rather than an art marketplace.

Being a pure play focused on art e-commerce definitely helps. Smart companies like Artifact and Saatchionline, backed by savvy venture capital in New England and Old England, respectively, have managed to reach the top 10 websites measured by an online art buying audience, thus bypassing established second tier auctions, less sophisticated internet start-ups and the world's major art galleries.

Liveauctioneers.com and Heritage Auctions have done a great job establishing a strong name over the internet for themselves, an achievement that may not be entirely obvious to art professionals focused on the offline world. The success of firms like Liveauctioneers.com that can make a living by focusing solely on enabling art and antiques auctions with their technology (and having no ambition to trade art of their own) provides a clear statement that art e-commerce is quickly developing into a sustainable and profitable industry in itself.

Company pairs like the auction houses Christie's and Sotheby's and information providers artnet and Artprice have a very strong rivalry, with the former having the advantage over latter in each case. In the Christie's vs. Sotheby's case, Christie's advantage is partially explained by aggressive buying of traffic with key words. Searches for "buy art online" or "art for sale" or a dozen other similarly standard queries bring web visitors to Christies.com as the topmost sponsored listing (at least as of mid December 2011).

The brave experiments of Art.sy and Seditonart.com, which launched only earlier this year and have relied heavily on social marketing, have managed to reach the top 30 in no time. This achievement is particularly respectable for Sediton, as it only offers a purely digital art concept.

Art fairs (including virtual ones) obviously offer no art trading today, but we included them here to juxtapose the existing dominance of the Art Basel brands (note separate slots for Art Basel Miami Beach and Art Basel) versus VIP Art Fair and to pinpoint the traffic gap that the New York-based VIP Art Fair will definitely challenge in 2012 under its new leadership (the company's new CEO, Lisa Kennedy, comes from an e-commerce background).

Artistic Merit

The classic debate about the art industry going online has traditionally centered on the specific art industry knowledge and expertise that the incumbent trade has (and safeguards) and that e-commerce challengers lack. eBay's past failures and its current flea-market like art listings remain the most widely used arguments to defend the exceptionalism of the art industry and how no stranger can possibly master an online strategy for the art trade.

This "special mission" and "not-like-the-rest-of-the-world" view of things is very close to us at Skate's, a company coded with Russian DNA in a country prone to such an "our own way" view of the world. We have seen this before. Resting for too long on ones laurels and ignoring massive technological and societal changes often causes one to miss the revolution taking place right in the backyard. With countries,

the best brains are drained away, leaving only a legacy of grandiosity perception, a perception that detaches itself further and further from reality with each passing day. As for the art industry, unless it responds quickly to changes taking place online, the noble art experts will all soon work for the brave new e-commerce firms, and the transformation of the art trade into a professional specialty retail trade will kill the old business model of art dealing and thus benefit newcomers who copy the efficient e-commerce business models of other consumer verticals.

Following the core thesis of this report above—the art market's expected decomposition into investment and consumer grades—Skate's believes that specialty art knowledge will enjoy less importance than the introduction of modern retail practices like branding, marketing, customer service and supply chain/inventory management going forward. In other words, to grow the art trade and bring in more consumers companies will have to be modern marketing experts first and art experts second. Granted, the art trade's movement online will only marginally affect trade in high value items—the premium market will largely remain as it is and will be further shaped by wider acceptance of art as an investment asset. The mass art trade, 95% of volume in terms of the number of works traded and the number of consumers involved, will migrate online, driven not by specialty art knowledge, but by the merger of art industry specifics with modern e-commerce conventions.

eBay is the best suited company to benefit from this migration. eBay's market capitalization as of December 21 was \$39.5



billion, which is 33% more than the total value of the world’s Top 5000 masterpieces by auction prices, 20 times more than the market cap of the world’s largest art industry company (Sotheby’s) and about 12 times more than the total market cap of Skate’s Art Stock Index of 13 global art industry listed companies. Once eBay figures out how to play the consumer part of the art market and move-up its cache (and average transaction size) in the space, it will be a difficult player to stop.

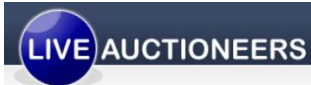


Going back to our figure skating analogy, we have played a lot with the methodology we will use to rate art e-commerce players. Our ratings will capture such qualities as vetting for art offered (e.g., no counterfeits, accurate authentication and limited counterparty risk), consistency of choice and its collector appeal and ability to integrate various specialty content-enhancing art buying and selling decisions. But we have concluded that no algorithm will work fairly. In figure skating, an algorithm is used and there is always a

scandal, so we thought that to make it easier for everyone, we can take the scandal without disclosing our synthetic ranking methodology. One thing is certain, however—we are not paid by any of the firms profiled and have no conflicts of interest.

In Exhibit 2, we included our top five picks for art e-commerce companies to watch. This is the product of our Technical Merit ranking normalized for specific art industry knowledge (Artistic Merit) and based solely on our subjective analysis. The most important caveat is that we have excluded Sotheby’s and Christie’s here because their stated objective is to focus on high-end items, and they have a lot to win by doing so as discussed in the first section of this report. Sotheby’s and Christie’s should not devalue their brand and trade their oligopoly position in high-end investment grade art for the benefit of long term e-commerce growth, regardless of their ability to play this game perfectly well.

Exhibit 2 – Skate’s Top 5 Art e-Commerce Leader to Watch*

Rank	Name	Skate’s Rating (0-10)	Note
1		9.975	The firm’s size is comparable to that of the entire art industry, and it has best in class e-commerce skills and long experience servicing the arts and collectibles market. It must reposition itself in the art space and implement on strategy to move itself upwards in value chain. This will happen either organically or through an acquisition.
2		8.375	A listed company with an excellent product offering, including both e-commerce and content, it has a stellar track record with no reported fakes or wrongly attributed works. artnet’s disappointing volumes are largely explained by a lack of modern e-commerce skills and need for a revamped business model and/or the introduction of professional e-commerce management talent.

3		7.750	A clear market leader after eBay with strong technological leadership, including those for mobile applications and the world's largest inventory sourcing and vetting ability, the company needs to introduce a B2C unit to build professional retail offering on top of successfully executed B2B solution for its venders.
4		7.250	The most aggressive and successful art auction that has consciously focused on an online strategy. The company's business model will remain handicapped until HA.com repositions itself as an art retail business and adopts focus on proper merchandising, more efficient product assortment and best in class e-commerce CRM. It should also aim to bridge the traffic gap with Liveauctioneers.com quickly, as this gap remains too wide.
5		6.775	A firm backed by venture capital that initially made the right move to aggregate various value-adding content but has somehow failed to reap benefits from full trading and content functionality integration. It has lost significantly to Liveauctioneers.com on traffic and HA.com on consumer focus.

Skate's rank as of December 18, 2011; Source: Skate's Art Market Research

3. Calendar of Conferences and Other Events in which Skate's Will Participate in 2012

Skate's will participate in the following conferences and other events in 2012. Please visit www.skatepress.com for updated information.

February	Moscow	The Russia Forum 2012
March	New York	The Armory Show
April	Tempe	Assets 2012 – the International Society of Appraisers Annual Conference
May	Havana	Skate's Insiders Club
September	Vienna	Art Industry Summit
December	Miami	Art Basel Miami

We would love to hear what you think of this analysis from Skate's. Please email us at skate@skatepress.com and we will be happy to post your comments online if you so desire.