BUSINESS

Sotheby's Investor Pushes on Properties

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Sotheby's doesn't just have an activist problem. It has a two-activists problem.

The auction house faces one hedge fund manager— Daniel Loeb of Third Point LLC—loudly banging down the doors over its performance. Meanwhile, another hedge fund is working behind the doors to get the company to sell its physical home.

That second hedge fund, Marcato Capital Management LLC, spelled out its arguments for the first time in a presentation to investors Wednesday evening. According to the presentation, reviewed by The Wall Street Journal, Marcato wants Sotheby's to sell its New York and London properties and unlock the capital it uses in its smaller art financing and art dealing operations.

The hedge fund, Sotheby's third-largest shareholder, believes those moves could free up $1.3 billion in cash, enough to buy back nearly a third of the company's stock.

The dual approaches against the oldest company listed on the New York Stock Exchange highlights the pressure companies can find themselves under when activist hedge funds take an interest.

"Sotheby's is committed to healthy two-way communication with its investors and welcomes thoughtful suggestions as we pursue our common goal of a strong, growing, competitive Sotheby's open to new opportunities," spokesman Andrew Gully said.

Richard "Mick" McGuire, the founder and managing member of Marcato, unveiled his thesis for boosting Sotheby's stock price at the Excellence in Investing conference in San Francisco.

Mr. McGuire met with Sotheby's in August and continues to speak with the company's management, a person familiar with the matter said. Sotheby's has brought in a new chief financial officer and said last month it would review how it allocates its capital, including looking at options for its real estate and using short-term debt to fund some operations with the aim of freeing up cash for shareholders. The review is expected to wrap up early next year.

The stock closed little changed Wednesday at $52.58, already up about 20% since Marcato first disclosed its holdings in the stock in late July. Mr. McGuire told investors he thinks the stock could rise to $68 if his plans are adopted. Still, given the cyclical nature of the art market with its seasonal auctions and demand for financing services, the value of the Marcato proposal is ambitious, according to a person familiar with Sotheby's thinking.

Meanwhile, the company is busy fending off Mr. Loeb. While Mr. McGuire is focused on financial engineering, Mr. Loeb launched an attack against Sotheby's strategy and management, saying they were losing ground against its 200 year rival Christie's International PLC.

Mr. Loeb said earlier this month that Sotheby's chairman and chief executive officer, William Ruprecht, wasn't the man to lead the company into the modern world of art. Mr. Loeb is an avid collector of contemporary art and has based part of his thesis on the company on his knowledge of the art world, people familiar with his investment have said. The hedge fund manager said he should join the board along with other art experts.

Sotheby's has called his letter "incendiary and baseless" and adopted a so-called poison pill to deter any activist investor from acquiring a stake greater than 10%. Third Point owns 9.3%, making it the company's largest shareholder. Marcato owns a 6.7% stake.

Sotheby's has since reported better-than-expected sales from an auction in Hong Kong, and analysts have projected strong sales for New York's November auctions.

Balancing the demands of both Messrs. McGuire and Loeb has been a constant concern for the company since the summer. "We get advice and suggestions from shareholders virtually every day," said Mr. Gully.

Mr. McGuire isn't an art collector and has never purchased a piece of art from Sotheby's, the person familiar with the matter said. His arguments against Sotheby's are based more in traditional shareholder activism: re-engineer the balance sheet and return cash to shareholders.

Still, he agrees with Mr. Loeb's arguments regarding strategy, though the two aren't working together on the investment, the person said. Mr. McGuire believes the balance sheet improvements are "low-hanging fruit" that can juice shares quickly. Afterward, the company can take a year or two to beef up its operations along the lines of what Mr. Loeb suggests, the person said.

The specific suggestions target Sotheby's financing and art dealing businesses. The auction house's financing business makes loans to collectors and dealers backed by artworks Sotheby's has lined up for sale. The dealer business buys and sells art using Sotheby's own balance sheet.

In the first six months of the year, Sotheby's generated about 3.3% of its total revenue from those two operations combined, according to the company's most recent earnings report. Mr. McGuire argued in his presentation that the company could borrow from banks to fund both operations and free up cash on its own balance sheet.

On real estate, Mr. McGuire argued for either an outright sale of the New York property, which he expects could fetch $500 million, or a sale-leaseback, where the company sells the building to a real-estate investor and enters a long-term lease to remain there.

Sotheby's has occupied its headquarters on Manhattan's Upper East Side since 1980. It bought the property for $370 million in February 2009.

In September, The Wall Street Journal reported that Sotheby's had received first-round bids for a potential sale of the 10-story building, including some from pharmaceutical companies that believe it could be repurposed for medical use. The company has enlisted the broker Eastdil Secured to market the building.

The auction house's London location on New Bond Street, where Sotheby's has been since 1917, is worth

$225 million, while other London properties are valued at $150 million, according to Mr. McGuire's presentation. Sotheby's said it didn't know what other properties the hedge fund manager was referring to. The presentation itself was vague on that point.

—Sara Germano
contributed to this article.