

Skate's Art Market Research

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Skate's Market Notes

New Star in the Global Art Industry Rises from the East (Expect IPO in 2012)

or

How the Chinese People Liberation Army Built the World's Third Largest Auction House in Just 6 Years

Since last year, Skate's has argued that it would make considerable sense for Christie's to go public in 2011 given the generous valuation multiples in the art industry. The momentum, at least for this year, has been lost for Christie's, as recent global stock market turbulence coupled with a stream of IPO cancellations have made it clear that investors' appetite for new deals has fallen significantly. Francois Pinault was apparently unable to jump on the IPO bandwagon last year given the previously planned departure of Edward Dolman, the CEO of Christie's for over 10 years who announced his move to the Qatar Museums Authority earlier this summer. Christie's is now unlikely to entertain any plans for an IPO in the immediate future as it digests the leadership change. The only art industry firm that benefited from the great window of opportunity was Poland's Abbey House, which successfully listed in Warsaw in May, as well as Switzerland's MCH Group, which completed a new issue this summer.

There is an interesting new story to tell, however, as Skate's has learned that the next art industry IPO will take place in China and will be made by Poly International Auction. Should the IPO take place as we expect, it would create the world's second largest publicly traded art industry company after Sotheby's.

While many art market professionals may have not heard of Beijing-based Poly International Auction, they should know the firm well. Following the first six months of art auction trading worldwide this year, Poly International Auction has moved into third place globally (after Sotheby's and Christie's) in terms of both the number of artworks and the combined value of art sold as measured by those works that are included in Skate's Top 5000 ranking of the world's most valuable art. As of July 25, 2011, Poly International Auction ranked above Russian-owned Phillips (currently the fourth largest auction) by selling 13 more works at a combined value of \$71 million higher. Another Chinese firm, China Guardian Auctions, has also advanced to take the fifth place ranking.

Exhibit 1 – Skate’s Top 5000 by Auction House

Auction House	# of Works in Skate’s Top 5000	Total Value of Works in Skate’s Top 5000, USD
Sotheby’s	2,332	13,763,857,408
Christie’s	2,196	13,527,169,024
Poly International Auction	137	711,853,696
Phillips	124	640,316,992
China Guardian Auctions	68	353,926,048
Tajan	16	66,345,996
Bonhams	13	38,864,416

Source: Skate’s Art Market Research, as of July 26, 2011

The global art industry is based on a complex web of relationships and the charisma of industry captains built over decades. Literally every art industry business of any significance has been associated with the name or names behind it. In rare examples of firms with business continuity spanning many generations, clever succession planning and the ability to attract powerful backers and leaders have been among the more important survival factors. Both established in the 18th century, the Sotheby’s and Christie’s of today are firmly associated with the leadership of Bill Ruprecht (for more than a decade) and the backing of Francois Pinault, respectively. Phillips is seen as a combination of ingenuity on the part of Simon de Pury, the media skills of its German executive Bernd Runge and the deep pockets of its Russian owners whose primary business is diversified luxury goods retail in Russia. From Gagolian to Gurr Johns, Artnet to Artprice, Taschen to Brant Publications, companies in the art industry are built around the DNA and charisma of their leaders.

Poly International Auction, on the hand, has succeeded in becoming the third largest art auction globally in just six years and has no big art market name attached to it. Who are the people behind this company?

Poly International Auction was established on July 1, 2005 by the Chinese Poly Group (China Poly Group Corporation). In the Chinese realities of today, the provenance of Poly International Auction is more powerful than the names of any individuals, as China Poly Group Corporation (CPGC) is as noble and blue (red) blooded as one can get.

CPGC was founded in 1983 as a joint venture between the People’s Liberation Army of China (PLA) and CITIC (Chinese International Trade and Investment Company), which in turn had been founded just five years prior to that by Rong Yiren on the blessing of Deng Xiaoping himself. The President of CITIC at that

time, Xu Zhaolong, baptized the firm with the Poly name, which in Mandarin Chinese means “defending the victory” and is also often used as a first name.

To make the branding message even clearer, the firm’s logo (the letter “P”) was selected as the first letter from the PLA acronym, and artists Lai Weiwu and Wang Xiaochao designed it, according to CPGC, to indicate “a fist with the meaning of confidence and power. The hollow part of the logo indicates to grasp the time and aiming the future.”



Today, CPGC is a giant diversified and government-owned holding group that apart from ventures in art and culture owns multiple real estate development and real estate management companies, as well as a myriad of international trading organizations dealing both in civilian and defense goods. The company’s activities are in line with the overall mandate from the Chinese government for CPGC to focus on commercial activities in “the major industries and key areas involving national security and national economy lifeline” and specifically “international trade of Military and Civil Products, Real Estate Developments, the culture and arts business and the investment in the mineral resources” (according to the corporate website of CPGC). In its 28 years of operation, this Chinese government-owned business hatchery has produced 44 listed companies, primarily in the real estate sector; it was among the top 100 tax payers in China in 2010.

The world’s third largest art auction house today, Poly International Auction is only a modest “granddaughter” (a subsidiary of a subsidiary) of CPGC and is part of what some would call a commercial version of the Chinese Ministry of Culture, Poly Culture & Art Co. Ltd (Poly Culture Group). Poly Culture Group in turn is a subsidiary of CPGC and is active not only in the art trading business but also in numerous cultural events and festivals, theatre companies, movie production and music recording. All of those activities are very commercially oriented, with Poly Culture Group reporting \$154 mln in revenue in 2010 and a gross profit of approximately \$40 mln.

If Christie’s does not enter the capital markets next year, then Poly Culture Group will be by far the hottest global art industry IPO coming up. We are aware that preparation for an IPO is already under way and has been blessed by CPGC and its Communist Party Committee (a very important milestone in Chinese corporate governance). Poly International Auction is the gem in the Poly Culture Group’s asset portfolio, and Skate’s is convinced that the recent surge in auction volumes at Poly was not only driven by strong speculative demand for Chinese art but also by CPGC’s intentions to float its “cultural subsidiary” next year on the local stock exchange.

Skate’s has analyzed Poly International Auction’s results for the first six months 2011, and we estimate that its 2011 sales should significantly exceed \$250 million, thus bringing its top line below that of the second largest firm in Skate’s Art Industry Stock Index—Switzerland’s MCH Group, the organizers of Art Basel (for more details on Index constituent stocks, please visit <http://www.skatepress.com/?cat=2>; for an extended Poly financial profile, please contact Skate’s by email skate@skatepress.com or call our New York office). However, should Poly Culture Group preserve its operating margins at the 30% level or higher and continue to be unleveraged, its IPO valuation could well exceed \$1 bln, which is four times the current market capitalization of MCH Group and just 2.5 times below Sotheby’s valuation. To put it a

different way, if Sotheby's had to spend an average of 100 years for each \$1 bln of shareholder equity it has created to date, Poly Cultural Group will have needed just seven years to create the first \$1 bln of equity value for the broiler farm of Chinese public stocks known as CPGC.

We welcome Poly Cultural Group's ambition to go public next year, as it would create the first Chinese listed public company and would shed some light on the true size of the Chinese art market. We remain puzzled by the motives and economic sources of market demand for Chinese art given the fact that the surge of trading volumes remains both the largest and the least understood source of global demand for high value art. It would be unfortunate, of course, to learn that the major driving force behind recent deals in the \$10-60 mln price range at Poly International Auction has been purchases by the state or the People's Liberation Army for their various museums. At this point we have no information that this is indeed the case, but given the speed with which Poly International Auction has catapulted itself to the global art market, we will watch very closely any disclosures that Poly Cultural Group will be required to make as it works towards an IPO to be completed following the publication of its full-year 2011 financial accounting some time next year. One prediction that is fairly safe at this point is that the world will be surprised yet again with the huge volumes and new price records for Chinese and possibly global art that will be set at Poly International Auction this fall. Stay tuned for the continued ascent of Poly in the global art auction rankings.