

Skate's Art Market Research

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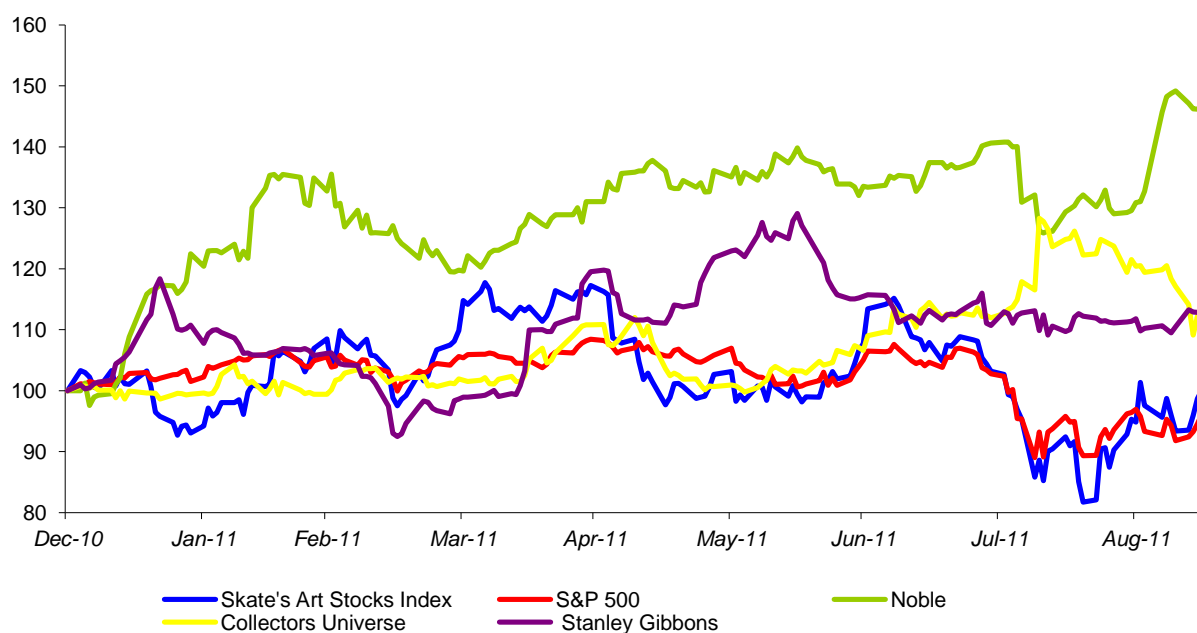
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Skate's Market Notes

Collectibles: Even Better Than Art Following Noble Investments' Inclusion into Skate's Art Stock Index, Three Art Industry Stocks Now Represent Collectibles Category

Following the overhaul of Skate's Art Stock Index (SASI) conducted on September 1, 2011 and announced the day before ([click here for story](#)) the index now has three companies representing the collectibles category. Collectors Universe and Noble Investments operate predominantly in the numismatics sector, and Stanley Gibbons primarily covers stamps. Following all three companies' recent six months financial reporting (Collectors Universe reported annual results as its fiscal year ends on June 30), we provide a comparative analysis that shows each company with an enviable business model that generates a strong cash flow despite continued global economic turbulence.

Exhibit 1 – YTD Performance of Collectibles Stocks versus Industry Benchmarks: Beating the Index!



Source: www.skatepress.com

Although the three companies representing the collectibles segment may represent only 10% of the total market capitalization of SASI, they are all true gems. All three have strongly and consistently outperformed both SASI and the S&P 500, and all three are very profitable (net profit margins in the double digits). With the exception of Noble, all saw double-digit growth, with Stanley Gibbons reporting a 25% revenue increase in the first six months of the year.

Below is a summary of our investment position with regard to each stock.

Collectors Universe: loaded with cash and at a strategic crossroads...

Collectors Universe, by far the largest of the three stocks profiled, is apparently doing very well.

A classic example of a well established art industry company, Collectors Universe has carved out its own niche, which it continues to milk, enjoying a near monopolistic position in its core market for coin authentication and grading services. It has no debt and sits on a pile of cash—\$22 million to be precise, which is roughly half of annual sales and 15 months of operating expenses. Its net income margin for the year was an enviable 11.5%.

The business is growing as well. Collectors Universe produced 11.7% revenue growth in 2011, achieving \$44.4 million in revenues and remaining strongly profitable with \$5.1 million in net income. The firm provides authentication and grading services to dealers and collectors of high-value coins, trading cards, event tickets, autographs, memorabilia and stamps (“collectibles”). The business model’s strategic premise is that authentication and grading services add value to these collectibles by enhancing their marketability and thereby providing increased liquidity to the dealers, collectors and consumers that own and buy and sell them.

Collectors Universe is essentially the benchmark for the collectibles market in the United States where the firm primarily operates. In 2011, it provided authentication and graded 3.3 million collectible items (2 million of which were coins) with a total insured value of \$1.4 billion (of which \$1.3 billion were coins).

Exhibit 2 – Collectors Universe: Product Mix

Metric	#	\$'000	\$	#	\$'000	\$
Fiscal Year	2010/2011	2010/2011	2010/2011	2009/2010	2009/2010	2009/2010
Product	Units Processed	Insured Value	Value /Unit	Units Processed	Insured Value	Value /Unit
Coins	1,973,700	\$1,292,000	\$654.61	1,708,200	\$1,390,000	\$813.72
Trading Cards	1,120,800	\$83,000	\$74.05	1,090,600	\$73,000	\$66.94
Autographs	240,100	\$21,000	\$87.46	196,500	\$18,000	\$91.60
Stamps	13,900	\$8,000	\$575.54	19,000	\$13,000	\$684.21
Total	3,348,500	\$1,404,000	\$419.29	3,014,300	\$1,494,000	\$495.64

Source: Collectors Universe, Form 10-K of 08/26/11

This product mix structure produces an interesting insight: since Collectors Universe has largely exhausted growth potential in higher value coins, it has had to grow into lower margin segments in recent years by adding less valuable units for grading. As a result, the average value per unit processed by Collectors Universe has declined by 15.5%, while the average value of coins, the company's core product, has declined by 19.6%. This should have triggered a dramatic decline of revenue per coin graded by the firm, but while this performance indicator did indeed decline, it did so only by a modest 1% from \$15.04 per coin per annum to \$14.89 per coin. As this service becomes a standard that needs to be met for coins to find buyers, Collectors Universe is essentially making its dominant market position work by forcing market participants to pay a higher percentage of a coin's value for its authentication and grading services. In 2010, the grading service was 1.8% of the coin's value, and in 2011, it has grown to 2.2%, thereby shifting the economic benefit from market buyers and sellers to Collectors Universe.

Yet despite its impressive performance, Collectors Universe clearly needs to look for new ways to grow. It would be tempting to suggest that the firm should try to bring its authentication and grading expertise to the art market, but in reality there is no indication that the company has either the desire or skills to expand in this way. Instead, Collectors Universe announced its first acquisition in years on Thursday, September 15 when it purchased a tiny firm called Coinflation.com for a total consideration of approximately \$750,000, of which \$200,000 was paid in stock and the balance in cash. Add to that the fact that Collectors Universe expects a three-year payback period on this investment and it is obvious that the acquisition will have no impact on the company's financials in the near future. Skate's believes the core rationale for this deal was to acquire e-commerce expertise needed by Collectors Universe for further improvement. Perhaps more important than the acquisition itself is the fact that Coinflation.com founder Alec Nevalainen will join the management board of Collectors Universe to lead the combined firm's journey into the digital world.

Skate's plans to publish an extensive research report on Collectors Universe toward the end of this year when the company publishes its first quarter results for fiscal year 2012 as its e-commerce strategy starts to take shape.

Noble Investments: an ideal match for Collectors Universe, but too happy on its own

If there is such a thing in the art industry as a marriage made in heaven—apart from affairs resembling the Sotheby's and Christie's price-fixing scandal that have since been strongly discouraged—it would probably be a merger between Collectors Universe and Noble Investments.

Market leaders in their home markets of the United States and the UK (Noble also has a small but notably successful footprint in Hong Kong), both Collectors Universe and Noble Investments are public firms with cultures of strong governance and disclosure. Listed on NASDAQ and in London, respectively, they also have astonishingly complimentary business models. Noble Investments is engaged in retail trading and rarities auctions, while Collectors Universe focuses on authentication and grading. Both firms focus on coins and look at stamps as an important second line of business.

Combine the two, and we would get a towering global market leader with \$65 million in sales and a fully integrated service platform that would span from specialist grading to branded retail. Together, both

companies make \$8 million in profits, and the first run of the synergies effect coupled with modest growth rates and international expansion could yield \$20 million in net profits for 2014 should Collectors Universe and Noble hypothetically merge early next year. Enter art industry multiples and the absence of leverage and we would have a combined group valued well in excess of \$350 million according to our financial model (or at more than a 50% premium to the sum of their current parts).

Alas, the above hypothetical should be dismissed as a fantasy of Skate's. In the real world Noble Investments is run exceedingly well and betrays no interest in being part of any merger. In fact, Noble's business model based on retail trading and auctions is even more profitable than that of Collectors Universe. With a 17.3% net profit margin (based on the first six months of 2011), it looks like a "numismatic Sotheby's" that happily pays dividends to its shareholders. In fact, Noble's board has increased the dividend payout by 30% this year so far, to which the market responded immediately by repricing the company's shares (see the cheerful spike of the green graph in Exhibit 1 above).

Skate's included Noble Investments into SASI as of September 1, 2011, and we will publish our first detailed research report on the firm early next year to coincide with its full year financial disclosure.

Stanley Gibbons: leading the way in online trading and global reach

Collectors Universe and Noble Investments are great companies, but Stanley Gibbons is a true gem. We turned bullish on Stanley Gibbons when we published our first comprehensive report on the firm in April of 2010; since then it has doubled its value for shareholders. As of today it is the fastest growing company in the collectibles market segment, and based on its six months 2011 results, it was only second to Sotheby's in terms of top-line growth rate having achieved a 25% revenue increase on a year-over-year basis.

The firm has also increased its dividend by 11% this year (shareholders of record can expect a dividend payout of GBX 2.50 per share on September 26).

The firm's business model is also heavily based on trading, with philatelic specialty retail being the signature offering of Stanley Gibbons, which has now been efficiently deployed to the Asian market. We remain strongly bullish on Stanley Gibbons and are raising further its target price to GBX 300 per share. This price increase implies continuous growth from Asia and the successful launch of an online trading platform that we are eagerly anticipating to take place later this year.

Skate's will publish an updated Stanley Gibbons research report in February 2012 once its full-year 2011 financial results become available.