Weekly Report

GRIFF
INVESTMENT FUND

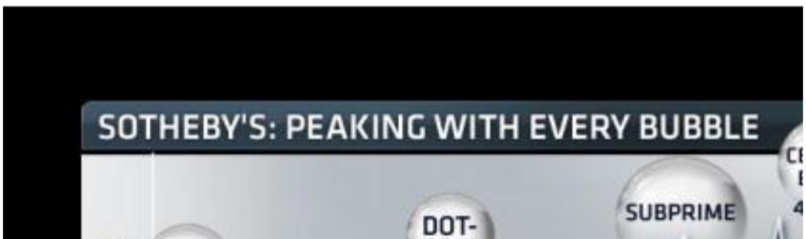
Equity Analysis

Sotheby's in a State of Flux

With art making up around 4% of high-net-worth individuals' total wealth, the art market is big business. Although some investors believe understanding the difference between Manet and Monet is essential for investment in this high-end industry, the improvement seen in Sotheby's (BID) 2014 Q1 figures speak for themselves. Total revenues for the first quarter show a 54% year-on-year increase, beating Wall Street forecasts by more than $27m, consolidated sales rose 32% and Modern and Contemporary sales in February earned $524,5m, the highest ever figure for this annual two-week series in London. However, the company is in a state of flux. The infamous activist investor, Daniel Loeb, has entered the board and intends to shake-things-up, cut management costs and increase Sotheby's online market presence to increase the value of his 9.6% share, whilst, in contrast, hedge fund manager Jim Chanos holds a short position on BID.

Monday May 5th saw the end of one of the most hostile battles between a shareholder activist and an investee company, seeing the Third Point fund gain three spaces on the board, including a position for billionaire investor, Daniel Loeb. Sotheby's share price has suffered during this battle, with shares falling far behind the S&P 500 in early 2014. Loeb likened Sotheby's to a faded painting that was in need of restoration, encouraging cut backs in management costs, of increasing importance with the emergence of Amazon and eBay's fine art offerings and the resulting weakening of Sotheby's and Christie's grip on the art market. However, this result limits uncertainty for shareholders and shifts focus to the company's strong position in a market with high barriers to entry and where luxury is essential. Earlier this year, Loeb criticised the lack of coherent strategic management of their internet offerings whilst direct competitor Christie's have shifted focus to more affordable art sold through online auctions. However, Sotheby's have maintained their luxury approach to sales with the use of showrooms and exhibitions, resulting in sales lagging behind Christie's and the auction house losing out on a £1.57bn internet pie. However, with Loeb's new position on the board and the potential to increase his stake to 15%, he may make changes towards a technologically developed Sotheby's, developing the lower-cost internet auction-place and increasing share returns as a result. Despite the corporate board reshuffle, Sotheby's have seen record London sales coupled with rising numbers of emerging market art collectors and a reported improved first quarter, just three days after Loeb's movement onto the board.

To add to Sotheby's state of flux, hedge fund manager Jim Chanos, described Sotheby's as a cyclical business in early April. Chanos argues that BID peaks during speculative bubbles, with the Japanese buying Impressionist work in the 1980s during the leveraged buyout boom and high Modern art demand in the dot.com bubble of the 1990s. The current market, which Chanos labelled the 'central banks bubble', is fuelled by Contemporary art sales that far exceed estimates and grossed in excess of $364m on May 13-14th. This indicates great overconfidence in the art market since many of these Contemporary artists are still living, allowing little time for appreciation. This highlights a peak in accordance with previous trends, potentially indicating the gains to be had by taking a short position on BID, or perhaps waiting for the post 'central bank' bubble fall in BID price. However, if Chanos' theory is correct, then this may be a potential signal to look further afield for the effects of a potential bubble.



Serco: Rupert Soames to deliver a turnaround?

Serco is an outsourcing company, taking on contracts from both the public and private sector, just like G4S - the famous company that came under scrutiny for security issues at the 2012 Olympics. The main difference, for investors anyway, apart from a different brand is the idea that G4S is a FTSE 100 company where Serco is a FTSE 250 company.

During 2012, both G4S and Serco came under the public eye as some of the government contracts they had taken on went sour which eventually led to Serco being unable to sign any government contracts in 2013. They could still bid for contracts but not officially sign them. This of course hit financials as profit margins were significantly smaller, between 47% and 62% smaller to be precise.

2014 is expected to be similar to 2013 as the increase in government contracts will be minimal. Australian security is also on the decline too. However, a gentleman by the name of Rupert Soames has taken over as CEO as of 1st May 2014. Soames is the grandson of Winston Churchill and managed to bring about significant success at his previous position as CEO of Aggreko. Aggrekos share price increase more than 925% over the last ten years, although whether Sercos share price will be have the same fruitfulness is debateable. Share prices are down just over 25% on the Year To Date (YTD) and dropped nearly 17% days before Soames joined, which personally is suspicious as maybe the profit warning released that caused this dip could have been a use of the accounting term named the 'big bath' technique. This in term would mean any shares Soames receives or buys now, will make that little bit more profit if his turnaround plans are successful. However, this is personal speculation and so wouldn't be a reason to invest in Serco - only that Soames could create a turnaround.

Serco have recently won the Caledonian sleeper service which is expected to earn £800m over the 15 year contract and will be an extension to their Northern Rail partnership. It's important to note that they have suggested that if a Scottish independence goes ahead, they will (or have said they will) continue the contract regardless without cutting any of the services or staff. They are planning to improve the quality of the cabins to create hotel style, en suite cabins. The ScotRail franchise is also up for renewal, with the winning bidder to be announced in the autumn.

It would be interesting to see where this company ends up and whether Soames can deliver a turnaround. Either way, profits have been hit with their recent scandals and their reputation is in tethers. This could continue or the company, either due to Soames or not, could make a turnaround.

Fund's Results

Holdings	P&L	Performance (%)	0.66%
Viscofan	4.01%	Performance (CASH)	£65.68
Diageo	0.11%	Invested Amount	£5,815.54
Morgan Stanley	5.65%	Cash Amount	£4,184.46
Honda	-6.42%	NAV	£10,065.68
Rolls Royce	-16.60%		
William Hill	2.72%	(Figures updated 30th May 2014)	
Premier Oil	13.02%		
Elementis	-0.63%		
Master Card	-3.07%		
GRTB	22.62%		
IBM	1.79%		

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Nikhil Kuplish
COO
nk652@york.ac.uk

Anna Murray
CEO

IBM	1.79%

Anna Murray
CEO
avm508@york.ac.uk

Ludger Pahler
CIO
lp870@york.ac.uk

Austė Vy
CIO
av638@york.ac.uk

Lorna Simmonds
Co-editor of the Weekly
ls958@york.ac.uk

Thomas Falco
Co-editor of the Weekly
tf613@york.ac.uk

Poppy Riley
Equity Analyst - Sothebys
pr630@york.ac.uk

Thomas Falco
Equity Analyst - Serco
tf613@york.ac.uk