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Skate's Art Market Research

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Skate's Market Notes

Publicly Traded Art Dealer: Let's Try Once More… Weng Fine Art AG Listed on Frankfurt Stock Exchange, Achieves 29.4% Single Day Price Jump Weng Fine Art AG Included in Skate's Art Stock Index Effective January 3

The proud city of Krefeld, located in the heartland of German manufacturing, lost its last publicly traded company on March 16, 2009 when the locally headquartered industrial conglomerate Jagenberg AG decided to go private. Had the citizens of Krefeld been asked what industry would return them to the global map of listed companies, common answers would likely have focused on new technologies, high precision manufacturing, top quality steel, chemicals, new materials and other areas for which North Rhine-Westphalia is famous. Such suggestions would have been wrong, however, as the Krefeld based company that went public today is an art dealer.

Although unexpected for Krefeld, North Rhine-Westphalia is not necessarily a strange place to host a successful art dealer. "The old money" German land is rivaled only by Bavaria in terms of wealth concentration and significant art collections. Krefeld is a short 20-minute drive from Düsseldorf, a vibrant global city of culture. The area is certainly a fertile ground for building an art business, and Weng Fine Art AG has clearly seized a major opportunity.

Established on December 1, 1994 by Rüdiger K. Weng, a former banker at Dresdner Bank, Weng Fine Art AG has quietly grown into a very profitable dealer. The firm has not participated in a single major art fair recently (we checked the listings in the catalogues of FIAC, Art Basel and Art Basel Miami Beach, Frieze and Vienna Fair from the past year and did not see Weng present at any). Furthermore, Weng does not have to pay the high street rents in London, New York or Hong Kong.

Instead of looking for new business at art fairs and in the glossy gallery space, Weng worked its established international clientele one-on-one, focusing on professional clients, including dealers, galleries, auction houses and other institutions. This business model definitely has merit, with Weng Fine Art showing consistent profitability and enjoying a net profit margin of more than 10% in the last two years. Based on its management accounts, Weng Fine Art has held to an efficient art dealer business model, trading art at a profit and maintaining a fairly stable book of business over the years.

Yet this story is one that we have seen before, and Weng is not the first art dealer to go public. Only one dealer is currently left in Skate's Art Stock Index—the British firm Mallett, a company which has been losing money for the last several years. In the past, our index has been populated by several dealers.

Artemis Fine Art was listed in France but went private after being sold to El Rocio Investments in 2006. German Camerawork technically remains a listed company in Germany, but we removed it from Skate's Art Stock Index last year due to a lack of stock trading and meager financial disclosure. British Partridge Fine Arts ran into financial difficulties in 2006 and went private upon its sale to Amor Holdings that year.

Exhibit 1 – Weng Fine Art AG: Historical P&L and Estimate for 2011-2012

EUR, thousands	2008-09	2009-10	2010-11	2011-12 (estimate)
Revenue	6,442.6	5,007.5	6,685.4	6,500
Other operating income	89.3	134.8	91.1	70
Cost of sales	4,470.5	3,374.1	4,309.1	3,820
Payroll	355.1	287.6	352.7	380
Other operating expenses	858.5	504	881.7	1,000
EBITDA	847.8	976.6	1,233	1,410
Depreciation & Amortization	32.1	35.8	35	40
EBIT	815.7	940.8	1,198	1,370
Finance Costs (including Interest)	442.5	286.8	194.1	240
Profit before tax	372.5	654	1,003.9	1,130
Income tax	130.8	211.3	314.5	350
Net Profit	**241.7**	**442.7**	**693**	**780**

Source: Weng Fine Art AG

One common trait among Mallett, Artemis and Partridge is that the cause of their financial troubles was poor management of working capital. Each firm built up significant inventory and after they were unable to sell even at cost, they all faced significant unrealized losses as they tied their capital capacity to their artwork inventories. Everything worked fine as long as debt financing was readily available, but once the economic downturn and liquidity crunch arrived, these companies were left on their own—bleeding and in search of an ownership change.

Although smaller and with revenues about half those of Mallett, Weng Fine Art has comparable inventory and significant debt. As of January 31, 2011 the firm had approximately EUR 10 million in inventory. It expects its inventory to grow to EUR 10.6 million by January 31, 2012, which corresponds to roughly 20 months of the firm's sales. Although it is likely that inventory values could be realized on the market today, the size of the inventory still looks to be a bit excessive given the firm's flat revenue dynamic in the current year.

Another concern is that Weng Fine Art carries a considerable amount of debt—EUR 5.7 million in current liabilities (although no long-term debt), which results in a Debt to EBITDA multiple of 4. We would consider this leverage aggressive for an art dealer today. In all fairness, Weng Fine Art provided us with sufficient information showing that major banks have confidence in the firm and that its open credit lines will enable it to mitigate the debt refinancing risk for now. Furthermore, the effective interest rate is 3.55%, which is low among industry firms. Nevertheless, even if insolvency is not a risk factor to be concerned about at the moment, we note that due to the amount of debt, growth remains problematic. Interest costs now eat up nearly 20% of the free cash flow that Weng Fine Art generates. In theory, a large inventory should have helped to grow sales and in turn justify such leverage, but unfortunately Weng's sales remained flat in 2011/2012 fiscal year.

For Weng Fine Art to enjoy a successful journey in the public markets, the firm must develop a compelling growth equity story on the back of its strong record of profitability. This story must be supported by solid internal controls and professional corporate governance. Should Weng to develop this story, it could end up following the unfortunate path of other art dealers that list on the market and leave the stock exchange if caught by the next economic downturn and liquidity crunch.

Weng Fine Art AG was admitted to trading on the Frankfurt Stock Exchange on January 2, 2011 and on January 3 its share price went up by 29.4% reaching EUR 20.70 per share, which gives the firm a market capitalization of EUR 10.35 million or $13.50 million (for official stock exchange page about Weng, please click here). Weng Fine Art AG currently has a free float of approximately 13%—the balance, directly and indirectly, is owned by Rüdiger K. Weng, who elected not seek to raise new capital for the company's debut on the Frankfurt Stock Exchange. It has been priced just below the current Mallett valuation of $15 million (equity value), making it the smallest company in our index.

Skate's will carefully review Weng Fine Art's business plans for 2012 and will publish a detailed follow-up story on early this spring. In the meantime, Skate's is very much satisfied with the level of financial and business disclosure produced by Weng Fine Art prior to its listing and are therefore adding the company to Skate's Art Stock Index effective today, January 3, 2012, thus expanding the index to 14 companies.

Exhibit 2 – Composition of Skate's Art Stock Index, January 3, 2012,

Name	Listing	Currency
Abbey House	Warsaw	PLN
Art Vivant	Tokyo	JPY
Artnet	Frankfurt	EUR
Artprice	Paris	EUR
Collectors Universe	NASDAQ	USD
Fotoeffect	Moscow	RUB
Mallett	London	GPB
MCH Group	Zurich	CHF
Noble Investments	London	GBP
Seoul Auctions	Seoul	WON
Shinwa Art Auction	Tokyo	JPY
Sotheby's	NYSE	USD
Stanley Gibbons	London	GBP
Weng Fine Art	Frankfurt	EUR