



**Signet Jewelers Limited**

**Fiscal 2017 Fourth Quarter Earnings Conference Call**

**March 9, 2017**

## C O R P O R A T E   P A R T I C I P A N T S

**James Grant**, *Vice President, Investor Relations*

**Todd Stitzer**, *Chairman of the Board*

**Mark Light**, *Chief Executive Officer*

**Michele Santana**, *Chief Financial Officer*

## C O N F E R E N C E   C A L L   P A R T I C I P A N T S

**Female Speaker**, *Cowen & Company*

**Lorraine Hutchinson**, *Bank of America*

**Simeon Siegel**, *Nomura Instinet*

**Brian Tunick**, *Royal Bank of Canada*

**Tom Nikic**, *Wells Fargo*

**Scott Krasik**, *Buckingham Research*

**Janet Kloppenburg**, *JJK Research*

**Dana Telsey**, *Telsey Advisory Group*

## P R E S E N T A T I O N

**Operator:**

Ladies and gentlemen, thank you for standing by. Welcome to the Signet Jewelers Limited Q4 Fiscal 2017 Results Conference Call. During the call, all participants will be in a listen-only mode. After the presentation we will conduct a question and answer session. Instructions will be provided at that time. If at any time during the conference you need to reach an operator, please press the star followed by the number zero. Please note that this call is being recorded today, March 9, 2017 at 8:30 AM Eastern Time.

I would now like to turn the meeting over to your host for today's call, James Grant, VP of Investor Relations. Please go ahead, James.

**James Grant:**

Good morning and welcome to our Fourth Quarter Fiscal 2017 Earnings Call. On our call today are Signet Chairman of the Board Todd Stitzer, CEO Mark Light, and CFO Michele Santana. The presentation deck we will be referencing is available under the Investors section of our website [signetjewelers.com](http://signetjewelers.com).

During today's presentation we will in places discuss Signet's business outlook and make certain forward-looking statements. Any statements that are not historical facts are subject to a number of risks and uncertainties and actual results may differ materially. We urge you to read the Risk Factors, Cautionary Language and other disclosures in our Annual Report on Form 10-K. We also draw your attention to Slide 2 in today's presentation for additional information about forward-looking statements and non-GAAP measures.

Now, I will now turn the call over to Todd.

**Todd Stitzer:**

Good morning. My name is Todd Stitzer and I'm the non-Executive Chairman of Signet. Over time I have met and conferred on numerous occasions with many on this call. As you know, one of my responsibilities is to serve as a bridge and sounding board between our shareholders and Management. I (inaudible).

**Operator:**

Ladies and gentlemen, this is the Operator. I apologize but there will be a slight delay in today's conference. Please hold and the conference will resume momentarily. Thank you for your patient.

Okay. We're back in the conference now. Please go ahead.

**James Grant:**

Okay, folks. Turning it over to Chairman Todd Stitzer.

**Todd Stitzer:**

Okay, we'll start again. Good morning. My name is Todd Stitzer and I'm the non-Executive Chairman of Signet. Over time I have met and conferred on numerous occasions with many on this call. As you know, one of my responsibilities is to serve as a bridge and sounding board between our shareholders and Management. I take this responsibility very seriously, so this morning I'm opening our discussion to provide significant context that addresses many of the questions we've heard from you during and following the media attention focused on the Company last week relating to a longstanding arbitration case on pay and promotions.

We chose today and this forum to discuss these matters with you because this is a complex matter that cannot be reduced to a simple soundbite or a clever phrase. The Signet Board and Management team have absolutely no tolerance for discrimination or harassment, and we have had strict anti-discrimination and anti-harassment policies and practices in place for decades. The portrait of Signet painted in recent media reports is irreconcilable to me with the company that I have served as a director and a chairman for more than five years.

We have taken seriously the allegations of sexual harassment prepared in connection with the pending arbitration matter, many of which go back decades. The allegations of sexual harassment focused on our leadership were denied under oath. By numerous indicators, Signet outperforms national averages in

the percentages of its store management staff who are female. In their 2016 Women in the Workplace Report, McKinsey & Company found that percentage representation of females in non-senior management of US corporations across all industries was 37%. The Bureau of Labor Statistics reports that 44% of all first-line retail sales supervisors are female. In the jewelry, luggage and leather goods subsector of the same report, the percentage of female first-line supervisors is 61%.

At Signet, 68% of store management staff are female and the Company's ongoing efforts to promote women in the workplace is reflected at all levels of leadership. Our better-than-benchmark level of female representation is the direct result of our steadfast commitment to practices that focus on all aspects of the employment experience at our company.

In addition, again according to McKinsey, 29% of all C-level executives in the retail sector are female. At Signet, 33% of all C-level executives are female, and 4 of Signet's 11, or 26% of its independent members of its Board of Directors are female; the latter is almost double the average percentage of female directors at S&P 500 firms which, according to a 2015 Catalyst Report, is less than 20%. This is the portrayal of Signet which our Board, our Management team and our valued team members recognize as their own, not the purported parallel universe represented by others. You can find information about the real Signet under the Corporate Responsibility tab on our Signet website.

I will now address, as best I can for a pending legal matter, the facts surrounding this pay and promotion arbitration case. This case was filed in 2008. It's focused on the Company's pay and promotions practices for women in certain positions with our field operations team, not sexual harassment. In fact, there are no legal claims on behalf of the class alleging sexual harassment. Let me repeat. There are no claims on behalf of the class alleging sexual harassment.

As a Board, we have taken the pay and promotions allegations in the case very seriously from the outset. We have thoroughly examined the facts and we believe the allegations have no merit. Accordingly, we have defended the Company vigorously in this litigation, and the outcome of the case will be determined primarily by statistical analysis, not salacious claims.

The case is complex and we believe there is significant confusion regarding the number of declarants who have made allegations of sexual harassment, which I want to clarify. The injunctive relief class certified under Title 7 automatically includes 69,000 current or former female employees who worked at Signet between 2004 and the present. Forty-three, read that, 43 of the class members or about 0.06% of the class allege they experienced any form of sexual harassment, and many of these allegations pertain to incidents that purportedly occurred from the 1990s to 2005.

Let me be absolutely clear. Even one instance of sexual harassment is unacceptable. I cannot really comment further except to emphasize that Signet has sought to continuously advance our journey of improvement in workplace practices.

During the last decade we've focused on consistently improving our policies and practices around equal employment opportunity and workplace culture. Examples of concrete steps we've taken include adopting employment policies and practice aimed at ensuring equal career advancement via standardized processes for setting salaries and promotions based on objective measurable metrics; implementing training and performance measurement tools to cultivate leadership traits and prepare team members for promotion within our organization. As a result of these employment and advancement initiatives, today, as noted above, more than 68% of all store management staff are women. Providing further EEOC-approved training courses to help managers recognize and prevent workplace behaviors that do not respect all team members, including field operations leaders and those who attend our annual managers and sales meetings.

Based on these efforts, all of which have been sponsored and supported by our Executive Leadership team, we believe Signet has a sound framework of policies and practices and a strong workplace culture built on a foundation of equal opportunity and respect. We have a culture in which capable women thrive professionally and advance, and the data support our success.

We also know that our commitment to fairness, equal opportunity, integrity and respect in the workplace requires continuous review and improvement. Today, as we continue our quest to be an employer of choice, we are announcing a number of additional steps to assure ourselves, our shareholders and our team members that our policies and practices are functioning as intended, and to identify areas where we can further improve.

First, the Board is forming a new committee focused on respect in the workplace. The directors who will serve on the new committee include Virginia Drosos, CEO of Assurex Health and prior Group President of Procter & Gamble; Marianne Miller Parrs, formerly Executive Vice President and Chief Financial Officer of International Paper Company; Eugenia Ulasewicz, who served as President of Burberry plc Americas division; and Helen McCluskey, former CEO of the Warnaco Group. Helen will chair the committee. These women comprise all our female directors and all are very familiar with the company since they joined the Board between 2008 and 2014. The Board has charged the committee to focus on programs and policies to support the advancement and development of our female team members.

Second, the new committee have plans to appoint an independent consultant to conduct a thorough review which will cover current and future company policies and practices regarding equal opportunity and workplace expectations, including those covering non-harassment training and reporting, investigation and non-retaliation.

At Signet, we do not tolerate discrimination or harassment of any kind and we want to be sure that the framework we have in place for reporting and responding to any such issues is robust and effective.

Third, the committee will establish an independent ombudsperson office to act as an informal third party avenue to provide confidential advice to employees, to address concerns regarding the issues in the workplace, and to provide options and strategies to assist them in the resolution of workplace concerns.

The ombudsperson is in addition to our currently available resources and will provide additional assurance to team members and management so that fairness and respect will always be the touchstones of how we treat each other.

It is the intention of this Board and this Senior Management team to make certain that our culture and our team members are fully supported at every level, because culture and people have made Signet the leading company in our industry.

Let's now shift to credit, customer service and business performance issues. As noted earlier, I spoke to many shareholders personally last year. We have valued your input, a direct result of which was forming board subcommittees last June on credit and customer experience. These committees have met regularly since then and are actively and directly engaged with Management. Here's an update on progress.

The Credit Committee, led by myself, and the Management team, led by our CFO Michele Santana, are currently deeply engaged in negotiations supported by Goldman Sachs to outsource our credit business. After evaluation of the various options available to the Company, outsourcing is our preferred option. Let me repeat. Outsourcing is our preferred option.

The negotiations are complex and time consuming and it's critical we negotiate and execute a transaction that creates value for shareholders and minimizes the potential disruption to our business from any

potential transition. As just one example of the complexity of a potential transaction, the recency ageing methods we use in our credit business are integrated into our financial systems which need, as a part of any transaction, to be transitioned to the financial system of prospective partners, all of which are based on contractual ageing methods.

While we're encouraged by our progress, there are no guarantees that we'll be successful in our outsourcing efforts. However, in the absence of an outsourcing transaction we continue to believe there are opportunities to optimize our credit business that will create value for our shareholders.

Finally, in regard to our credit business, we absolutely reject any notion that Signet manipulates either its numbers or its customers. The 'Great American Retail Business' was built on consumer credit provided by retailers. While we respect that this system is in transition, we are providing a valuable service for our customers, enabling them to celebrate life and express love.

As a public company, our financial statements which include the result of credit operations, are annually audited by a Big 4 accounting firm. The consistent results of these independent audits validate our compliance with US Generally Accepted Accounting Principles.

It's regrettable that our use of the recency ageing method, a credit business management tool which we've applied in our credit business consistently and successfully for over 30 years, has been distorted by certain members of the financial community to advance their own narrative about our business. In reality, the recency method actually enables customers to better maintain their credit rating, and we are after all interested in serving our customers.

That being said, should we decide to retain and optimize the in-house credit business, we will change to contractual ageing.

Turning to customer experience. Based on the Company's investigations, reports of systemic diamond swapping are categorically false, but to address any customer concerns and prevent any potential one-off incidences, the Company is taking a number of steps. In order to continue to improve our tracking process, we've initiated a capital intensive measure to provide additional insurance for our customers; the rollout of proprietary digital gem scopes that create a digital pictorial record of a jewelry piece as it moves through our process. While we believe this represents a competitive advantage and another—this should go a long way to make our customers feeling even more secure in doing business with, and it will be these gem scopes will be in all of our national brand stores by the end of the year. We believe this presents a competitive advantage and another reason why customers should be confident in choosing Kay, Jared and Zales for their fine jewelry.

The Customer Experience Committee, chaired by Dale Hilpert, the former CEO of Footlocker, has also been directly involved in the company's decisions to adapt the organization structure and leadership which you've recently heard about, to the needs of today's omnichannel retail environment. This also includes making recent changes in internal and external IT resources and Mark will discuss these changes in his presentation.

Before I conclude on these opening remarks I'd like to focus on the elephant in the room, performance. With the backdrop of the Company's recent performance, the decline in the Company's share price and the recent media focused on the aforementioned arbitration, a number of you have asked me about Management's fitness for purpose. I've also been asked whether information regarding the lawsuit was taken into account when Mark was appointed CEO. Let me address the latter question first.

As a board, we have been briefed on this litigation since 2008. As noted earlier, many of the allegations publicized in connection with the case go back decades. When evaluating whether to make Mark Chief Operating Officer in 2014, we obviously reviewed his business performance and evaluated with advice



from counsel the allegations that were described in connection with the case, reviewed the available information, the timeframes involved, and the context in which it was offered. Based on our review and evaluation, we appointed Mark as COO. When the previous CEO departed the Company, we conducted a further confirmatory review and Mark was appointed CEO.

Over the past decade, particularly since 2009, our Management team under Mark's leadership has guided quarter to quarter and year on year growth that has been consistent and high quality. As you'll hear from (inaudible) benchmarked against others in the jewelry and against the retail industry generally, our results have outpaced the pack and this doesn't include the results of the Zale acquisition.

Turning to Zale, while the integration is not fully complete, the 2014 acquisition of Zale has been a success. This major strategic move required executive leadership with highly refined industry understanding to integrate and define synergies to unlock the kind of benefits we're now seeing. We are confident we will deliver an incremental \$70 million of synergies by the end of Fiscal '18, which means we will have delivered \$250 million of cumulative synergies from this value-creating transaction. This stands in stark contrast to the results achieved in most acquisitions.

We acknowledge that we've had a challenging 2016 or Fiscal 2017, due in part to our own shortcomings as well as a challenging retail and jewelry category environment. Our performance during the holiday season was significantly impacted by issues in our Sterling e-commerce platform which we have worked furiously to address. Just to be clear, had our Sterling e-commerce platform performed at the level of the Zale platform, it would have favorably impacted Q4 comp store sales by 100 basis points and full-year comp sales by 60 basis points.

To summarize, our Board is very focused on Management's performance. During the course of a very challenging year, the Board and I have become much more actively involved with the business and we'll continue this enhanced level of involvement as we take seriously our responsibilities to guide and evaluate the strategic direction of the Company on behalf of all of our shareholders.

We believe the antidote to business challenges is strategic vision and effective execution. While the Board currently believes the Signet Senior Management team is the best situated to deliver in both of these key areas, you can be sure that we will be intensively engaged and very focused on ensuring capable execution of these key initiatives.

Let me now turn the call over to the Executive Management team. Mark.

**Mark Light:**

Thanks, Todd. Good morning everyone. I would like to start by discussing some of the key points we would like you to take away from our fourth quarter presentation. In a challenging retail environment, our team delivered some wins in certain fashion jewelry categories and selling channels. Our sales decreased, our EPS increased and our fourth quarter financials overall were in line with our revised expectations. We also managed our SG&A and inventory well which not only helped earnings but also increased our free cash flow substantially year-over-year.

We delivered more than our anticipated synergies through operating expense management, which helped us protect our profit, our profit margins and our cash position. The P&L benefits of our synergies which are net operating profit contributions were offset by the slow sales environment and our business investments.

We have important initiatives in our business this year around line extensions, Clienteling and more, but perhaps the most significant opportunity is adapting to the retail environment with an extensive omnichannel focus.

We have realigned our executive organization structure to reflect customers' multichannel interactions with us. We are making greater technology investments to improve customers' online experience, and our digital marketing and online presence will be more pronounced than ever.

We delivered on our balanced approach to capital allocation and for the year we repurchased a billion dollars of our stock and increased our dividend for the sixth year in a row.

Lastly, as announced last year, we've initiated annual same store sales and earnings per share guidance in lieu of quarterly in order to foster a more long-term view on Signet, which is how we think about our business.

Now let's move on to some of the drivers for the fourth quarter top line. From a category standpoint, diamond fashion jewelry led by earrings and bracelets were top performers. Our Ever Us two-stone diamond jewelry collection sales more than doubled year-over-year, and the Very Wang Love Collection did well, driven by thoughtful line extensions, distribution and marketing.

From a selling channel perspective, Kay off-mall stores performed relatively better than mall stores. Also, Piercing Pagoda delivered another outstanding period of growth driven by sales of 14 karat gold jewelry, which include chains, religious jewelry and children's jewelry.

As for what drove the fourth quarter sales decline, there were a few related factors that were secular and company-specific. First, the retail promotional environment. Share of wallet competition for disposable income among all types of retailers and all selling channels was exacerbated by significant discounting. While Signet was more promotional than last year, we chose to balance our promotion level to protect margins.

Second, the US jewelry industry. According to MasterCard Spending Pulse, jewelry and watch sales were approximately flat in the fourth quarter with the brick and mortar stores down about 6% and e-commerce up over 20%. The jewelry industry did not perform as well as overall retail. Independent jewelers forced to discount liquidated in numbers not seen since the recession, and costume jewelry outgrew fine jewelry.

Third, dynamics around our selling channels. Clearly there was a secular shift to online. Signet e-commerce sales are significantly lower than expectations due to the underperformance of technical enhancements applied across all of our Sterling division store sites, especially in Kay and Jared, which use a common e-commerce platform. Sterling e-commerce enhancements did not perform to expectations when exposed to the high fourth quarter volume, resulting in purchasing disruptions. Importantly, the growth we experienced in Zales e-commerce was very encouraging.

Our mall stores underperformed primarily because of lower customer traffic and deeper jewelry promotional activity elsewhere, which we chose not to match and protected our margins instead. We are responding with a variety of initiatives and process improvements around the omnichannel experience, merchandise innovation, IT modernization, square footage reduction and store operations improvements. I'll get into more specifics on Slide 9.

Although Fiscal 2017 had its challenges, Signet delivered several important accomplishments in our stores and demonstrated good financial management. Key merchandise brands and categories had a good year, such as Ever Us, Neil Lane, Vera Wang Love, Endless Brilliance and Chosen, plus bracelets, necklace and earrings. Piercing Pagoda and our Kay stores off-mall delivered higher sales; good expense management which helped us deliver operating margin expansion of 120 basis points. Our free cash flow increased by \$184 million to \$400 million. Ending inventory was flat due principally to prudent management including the realization of big improvements within the Zales merchandise portfolio. We



executed substantial share purchases and several executives and board members were buyers also. For the sixth year in a row, we increased our quarterly dividend, and we have substantial liquidity and an attractive yield.

We entered into a private investment in public entity with Leonard Green. The transaction was a significant vote of confidence in the Signet operating model. We opened our books and we shared significant amounts of information. With the benefit of full due diligence, Leonard Green invested \$625 million in Signet. We delivered on our synergy targets and improved the efficiency with which we do business.

In Fiscal 2017, we delivered \$120 million of synergies. For the full year, the Zale division delivered an operating income of \$73 million and an adjusted operating income of \$90 million. Those are increases of 41% and 15%, respectively, which led to operating margin expansion.

I won't go into depth of each of these drivers on Slide 7 and the detail behind each one, but as you can see we've got a tremendous amount of activity going on to fully optimize the business. The unit economics on every repair we do at Zales is better. We are utilizing discounts with greater discipline. Across Signet, we buy more effectively than ever and that includes diamonds as well as products and supplies not for sale. Our Zales stores inventory is turning faster. Our distribution center consolidation gets underway this year. We've eliminated duplicate corporate positions and we have better aligned store compensation and total rewards throughout Signet. These examples and other projects are positioning us well to build upon our long history of growth and to improve profitability.

Before we get to opportunities for Fiscal 2018, a few words on the jewelry industry. In the last 25 years the jewelry and watch industry in the United States has grown at a 3.8% compounded annual growth rate. During that time period, the industry has seen some dips but the industry has been generally resilient.

At present, the industry is certainly facing some challenges, but we believe those challenges, as in the past, are short-term in nature. Over the last seven year post-recession, Signet US total sales have grown at a 12% compounded annual growth rate. Even without the Zale acquisition, our US compounded annual growth rate is 7% over that timeframe. Signet has consistently outperformed the jewelry industry.

Given the fragmented industry, we believe we have many years of profitable growth and market share gains ahead of us. Our brands, our scale and our people give us a competitive advantage.

We are in a consolidating industry. According to government figures, jewelry in the US is growing in dollars and declining in the number of doors, and we have three of the most pre-eminent brands in the jewelry space.

Now I'd like to discuss some of the strategic initiatives underway that will help us improve upon Fiscal 2017 and lead us to success in Fiscal 2018.

The retail sector as a whole is seeing an accelerating shift in customer behavior with significant movement towards more online browsing, shopping and purchasing. Signet is responding in a number of ways to succeed in this evolving retail landscape.

We are focused on the Customer First omnichannel experience. It is clear that relentlessly delivering and exceptional omnichannel customer experience is a retail imperative. We have recently realigned our organization around this imperative in which we created a new role of President and Chief Customer Officer. This role will sharpen Signet's focus on delivering an exceptional and unified omnichannel experience.

Under the strategic umbrella, Signet must be agile, it must be innovative and have the ability to adapt with technological advances and customer preferences. This year we are focused on the following. Initially and immediately improving the customer experience of our Sterling division websites. Technical enhancements have begun and will continue through the next few months. For example, we expect page load speeds to be cut in half as compared to the holiday season, which by the way is in line with retail norms, and this will be done by Mother's Day. Over the next few months, we'll have renewed and targeted focus to improve online traffic. For example, the site architecture enhancements will improve the search engine optimization rankings and we will (inaudible) and increase user-generated content.

In the summer, the new Zales e-commerce platform will launch. This has been part of our technology upgrade plan for some time and we will provide a better user experience and a more efficient operating model for the Company.

In Fiscal 2018, we are substantially increasing investments in digital marketing, especially in 'Search'. We are investing in enhanced data analytics to achieve a comprehensive view of our current and future customers. We believe we have one of the largest jewelry customer files of emails, customer profiles and more and we will use this information as well as the valuable credit data to be smart digital marketers.

Additional technology investment will be tested this year to enhance the customer journey and experience. For example, online wishlists and bridal configurators.

From a merchandise perspective, innovation remains a top priority. We have fresh new merchandise line extensions and redesigns of certain key collections. We are building upon existing trends, devoting more resources and store space to hot categories. At the same time, our pipeline of new ideas is full with strong candidates being tested today for possible holiday season rollout.

We continue to make investments in IT modernization that'll provide the backbone for the future, enabling successes and operational efficiencies. In Fiscal 2018, we expect to implement an enterprise-wide finance and human resource system; also, the North American warehouse management system that enables us to consolidate the Dallas Distribution Center into Akron.

We are also adjusting to changing customer shopping behaviors and we have taken the opportunity to accelerate store closings, especially within our regional banners. We anticipate closing stores will improve the overall profitability of our store base. In addition, new store openings will be focused on Kay off-mall centers where we have a higher return. These actions, coupled together, further enhance our diversified real estate portfolio between mall and off-mall locations.

Finally, we'll improve store operations execution by gathering more useful data about our customers' experience that will drive action to improve our customer conversion.

That concludes my prepared remarks and now I'll turn the call over to Michele.

**Michele Santana:**

Thank you, Mark, and good morning everyone. All right, I'm going to start with covering Signet's fourth quarter sales. For the fourth quarter, Signet's comps decreased 4.5% against an increase of 4.9% in the prior year fourth quarter, and compares to a two-year comp hurdle rate of 9.1%. Total Signet sales decreased 5.1%, and on a constant exchange basis, total sales decreased 3.3% for the quarter.

Sales on an operating segment basis were as follows:

In Sterling Jewelers, total sales declined 3.7% to \$1.4 billion. Comps decreased 4.9%, compared to an increase of 5% last year, and compares to a two-year comp hurdle rate of 8.7%. Average transaction

value increased 7% and the number of transactions decreased 11.4%. ATV increases were driven primarily by higher value diamond jewelry coupled with declines in select lower average selling price points, such as our Charmed Memories.

The Zale Jewelry operating segment total sales decreased 3.8% to \$555 million. Comps were down 5.2% against a two-year comp increase of 8.2%. Average transaction value increased 2.4%, while the number of transactions declined 7.4%. Increases in higher price point diamond fashion jewelry and bracelets were more than offset by unit declines across all other merchandise categories.

On a geography basis, our Zales US total sales decreased 3.5%, while comps decreased 4.9% against a two-year comp hurdle rate of 8.6%. In Canada, total sales declined 5.6% and comp sales were down 7.2% against a two-year comp rate of 5.8%.

For the Zale Jewelry operating segment, declines were broad-based across merchandise categories and impacted by underperformance in the mall channel.

Piercing Pagoda total sales increased 7.2% to \$84 million, with comp sales of 5.7%, and that's on top of a 6.4% comp last year and a two-year comp rate of 9.1%. Average transaction value increased 12.7%, while the number of transactions declined 5.6%. Sales increases and ATV were driven by 14-karat gold, religious and children's jewelry, while unit declines were driven primarily by fewer piercings.

In the UK, our total sales decreased 19.5% to \$228 million, but decreased 3.3% at constant currency rates. Comp sales declined 3.8% on top of a 4.7% increase in prior year and a two-year comp hurdle rate of 12.2%. Average transaction value increased 8% and the number of transactions decreased 11.8%. Stronger sales of prestige watches and bridal jewelry were more than offset by lower sales in select fashion jewelry and fashion watches.

Moving on from sales, we'll look at Signet's consolidated and adjusted results. So seen on Slide 11, we're presenting this reconciliation for the final time reflecting the impact of purchase accounting, as well as IT implementation expenses associated with global systems that will drive future efficiencies and cost benefits. IT and other non-routine expenses, as well as purchase accounting, will be a factor in Fiscal 2018, but these costs will be lower than FY17. As these costs are no longer unique to Signet and are becoming less material, we don't believe it's necessary to provide a separate presentation and non-GAAP reconciliation on a going-forward basis.

The difference between Signet and adjusted Signet on this slide are in the columns reflected purchase accounting and integration costs.

So, starting on the lower left portion of the slide, on a GAAP basis, earnings per share was \$3.92. In the next column over, purchasing accounting adjustments of \$2.2 million were worth \$0.03 of EPS dilution. This was driven primarily by deferred revenue adjustments related to acquisition accounting.

The next column over reflects our integration costs, which relate primarily to consulting expenses associated with IT implementation, severance related to organization changes, and expenses associated with the settlement of miscellaneous legal matters pending as of the date of the Zale acquisition.

Net integration costs of \$6.1 million were responsible for \$0.08 of EPS dilution. On an adjusted Signet basis, in the far right column, by adding back the \$0.11 worth of adjustments, our adjusted EPS was \$4.03.

So going below the sales line of Signet's adjusted P&L results, our adjusted gross margin was \$947.2 million, or 41.7% of adjusted sales, down 90 basis points. This decline was driven principally by lower sales leading to deleverage on fixed costs, as well as more promotional activity in the holiday period.

This was partially offset by the adjusted gross margin rate improvement in the Zale division of 40 basis points, as a result, on a higher merchandise margin rate of 120 basis points associated primarily with synergy benefits.

Adjusted SG&A was \$603.8 million and that's down \$62.2 million from last year. Our SG&A rate of 26.6% leveraged 120 basis points despite lower sales due to expense reductions over prior year. The decline in dollars was driven primarily by lower variable compensation, including both short-term and long-term incentives, as well as other factors that I'll elaborate in a minute.

Other operating income was \$69 million or 3% of sales. The increase of \$5.3 million was due principally to higher interest income earned from higher outstanding receivable balances. Adjusted operating income was \$412.4 million, down slightly by 1.4%. However, our adjusted operating margin rate was 18.1%, up 70 basis points, due to strong operating expense management and a lower sales environment.

Adjusted EPS was \$4.03, compared to \$3.63 last year, an increase of \$0.40, or 11%, and that's driven in part by a more favorable effective tax rate, as well as fewer shares outstanding.

So, taking a closer look at our adjusted SG&A, our teams continue to focus on cost controls and savings. Our adjusted SG&A expense declined \$62.2 million, or 9.3%, in the fourth quarter. The cost controls coupled with synergy benefits, resulted in significant leverage, as I previously noted. Within SG&A, the biggest expense component is payroll. Store and corporate payroll declined, due to primarily to lower variable compensation, which flexes with sales, as well as lower corporate short-term and long-term incentive compensation. In addition, synergistic benefits around payroll also contributed in part to the decline. Favorable foreign exchange in the UK was also a factor. We reduced advertising expense, primarily in the Sterling Division. This was due to a change in the mix of commercial spots and reductions in certain media, such as direct mail and catalog that have a lower ROI associated with them. In other expenses, the main driver was lower merchant fees in the Zale credit program. These savings were partially offset by an increase in information technology projects, which Mark had previously discussed.

So, before we move on to a few balance sheet highlights, I want to touch briefly on synergies.

In Fiscal 2017, we delivered an incremental \$120 million in synergies, for a cumulative two-year total of \$180 million. Our synergies were primarily generated in gross margin, and in part in SG&A, related to the key activities that Mark had outlined. The FY17 synergies protected our profit and cash generation in what turned out to be a challenging year. The slowdown in our Fiscal 2017 sales and its unfavorable impact to our profit, coupled with our IT investments, offset the financial contributions of our synergies. As we move into FY18, our focus will continue to be on additional gross margin cost savings and SG&A.

So, moving on to P&L, I'll focus on a few balance sheet highlights.

So, for inventory, our year-end inventory position reflects the success of our continued focus on inventory optimization. Net inventory ended at \$2.45 billion. Our teams did a good job of managing inventory levels in a slow environment. The flat inventory level on a total annual sales decline of 2%, compares relatively well to many other retailers, many of whom have had less success managing inventory levels and generating cash in this highly promotional and challenging period. We saw sound prudent management of inventory across categories and divisions. It's also worth noting the Zale division inventory declined at a faster rate than Signet overall, and this is directly related to the synergy-producing initiatives that Mark described earlier, which we call inventory turnover improvement. Finally, Signet benefited from foreign exchange on inventory procured in currencies other than the relatively strong US dollar.

So now we're going to our attention to our in-house credit metrics and statistics. Given the seasonality of credit sales and collection, it is much more instructive to look at full-year credit metrics rather than a quarter.

Fiscal 2017 credit sales in the Sterling division were \$2.44 billion, down 0.5%. Although lower, the in-house credit sales were more favorable than the division's total sales decline and therefore gained relative share in the mix of tender. Our in-house credit penetration was 62%, up 50 basis points, on the relative strength of our credit sales versus non-credit sales.

Gross accounts receivable increased \$96 million, or 5%, to \$1.95 billion. The receivables group (inaudible) sales and unit sales were down due to higher credit participation, a higher average transaction value on what was financed, and due to the collection rate. The average monthly payment collection rate for Fiscal 2017 was 11% compared to 11.5% last year. Our monthly collection rate is calculated as cash payment received divided by beginning accounts receivable. The decline in the collection rate is due principally to a continuation of a shift in credit plan mix and an increase in the average transaction value of what is getting financed. As a result, monthly payments are higher in dollars, but lower as a percent of balances, thereby resulting in higher receivables outstanding to be collected.

Interest income from finance charges, which makes up virtually all of the Other operating income line on our income statement, was \$278 million, compared to \$253 million last year. The increase of \$25 million was due primarily to more interest income on the higher outstanding receivables base.

Our net bad debt was \$212 million compared to \$191 million last year. As a percent of receivables, the nearly flat bad debt allowance, which you'll see in a moment, was driven primarily by low receivables growth which was a symptom of the overall sales decline. The net impact of bad debt and finance income generated an operating profit of \$66 million, up \$4 million from last year.

Now, I'll take you through some of the key Sterling division allowance for doubtful account metrics.

Our total valuation allowance as a percent of gross receivables was 7.1% in the fourth quarter. This slight increase of 10 basis points was driven by the impact of lower sales leading to lower receivables growth. As new current receivables come onto our portfolio more slowly than the steady predictable growth in the allowance, it impacts our ratio a little unfavorably. On a sequential basis, the ratio was down 80 basis points, the same as prior year, reflecting seasonality changes.

The non-performing portion of our receivables as a percent of the gross AR was 4.1% in Q4. This was unfavorable by 10 basis points both year-over-year and on a sequential basis due to the slower credit sales.

So, before I move on to our financial guidance, just a few words about our credit strategic review. We are making great strides in evaluation of the alternative scenarios. An outsourced model would involve two lenders, a primary and a secondary. We have made progress in terms of our potential primary partner and we are heavily engaged in analysis and discussions with potential secondary partners. We have stated in the past we are motivated to announce a resolution as quickly and as prudently as possible in order to remove uncertainty around this issue for all of our constituencies.

So, a few highlights regarding capital allocation.

Coming out of Fiscal 2017, the key tenets of our capital allocation strategy remain in place: strong balance sheet for flexibility, investment grade rating, an adjusted leverage ratio goal of 3.5 times, and distributing about three-quarters of our free cash flow to buybacks and dividend growth. We had a great year of free cash flow, generating \$400 million, an increase of \$184 million. We repurchased 11.2 million shares for about \$1 billion, and that includes \$625 million to offset dilution from our preferred convertible



offering. This significant buyback activity demonstrates our commitment to providing shareholder value and our confidence in the long-term value of this company. Finally, as Mark has mentioned, we increased our dividend for the sixth year in a row.

Turning to our financial guidance, today we are initiating annual guidance for Fiscal 2018. Same store sales are expected to decrease a low- to mid-single-digit percentage. While we are confident in our strategic initiatives to drive business this year, we have also factored in three negative comp quarters in a row, a tough retail environment, particularly through Valentine's Day, and certain opportunities that may not come to fruition until holiday. We think modestly negative comp guidance is fair. While we are not guiding quarterly comp sales, there are a few items that are worth highlighting.

As published in our news release this morning, Fiscal 2018 is a 53-week year which has important timing implications for Q1 and Q2 around Mother's Day. About 300 to 350 basis points of same store sales and about \$0.12 to \$0.15 worth of EPS should shift between Q1 into Q2. In addition, the 53-week year also increases Q4 total sales but has no impact on EPS for that period, due to advertising expenses in that last week. The 53rd week is estimated to be worth about \$75 million in sales and is excluded from comp sales calculations. Directionally, we would anticipate that our quarterly comp sales are affected by the anniversary that they're up against. We expect to leverage gross margin in Fiscal 2018 with SG&A deleveraging. We anticipate synergies of about \$70 million, of which \$50 million of that is expected to flow through gross margin, which should produce leverage, while the remainder flows through SG&A.

Key initiatives driving gross margin include repair, discounting, procurement and corporate streamlining of our processes. From an SG&A perspective, key initiatives continue around organizational structure and payroll savings. We plan to continue investing in IT, which carries incremental expense, and as such, we anticipate SG&A to deleverage on lower sales. Key investments relate to omnichannel and other IT projects that will strengthen our customer service proposition and our infrastructure for the long term.

Earnings per share is expected to be \$7.00 to \$7.40. Now, keep in mind that this EPS range is as reported. Last year, integration costs which were excluded from adjusted EPS were \$24 million. This year, they'll be in a range of \$13 million to \$15 million, and consists primarily of severance and IT implementation costs. Also, this year's EPS will still have the effect of purchasing accounting adjustments of approximately \$17 million. This is flat to last year, but excluded in last year's adjusted EPS. So, these expenses in FY17 do not go completely away in FY18. They just don't warrant a non-GAAP presentation.

The effective tax rate is expected to be 24% to 25%, driven by the jurisdictional mix of our pre-tax earnings. Tax reform agendas remain a priority in the US, as well as outside of the US. Our effective tax rate guidance excludes any potential effect from tax reform.

The weighted average common shares outstanding for the year should end up at about 74 million to 75 million shares. This includes the as-if converted impact of our convertible preferred shares. It does not include any impact from the resolution of our credit strategic review. When we complete the review, we will communicate any potential incremental impact to our share count.

The mix of our capital expenditures will change in favor of technology and omnichannel investments. Consistent with that strategy, store square footage is projected to be flat to down slightly, primarily due to accelerating the number of regional store closings.

With that, that concludes my prepared remarks and I'll turn the call back over to Mark.

**Mark Light:**



Thank you, Michele. I'd like to close by saying, although the year did not go exactly how we would have liked, we still believe we have many years of profitable growth and market share gains ahead of us. Our brands, our scale and our people give Signet a competitive advantage. I would like to thank all the Signet team members for their hard work and dedication during the fourth quarter and throughout the entire fiscal year.

With that, we'll now take your questions.

**Operator:**

At this time, those with questions should lift their phone receiver and press star, followed by the number one on their telephone keypad. To cancel a question, please press the number sign. Please hold for a brief moment while we compile the Q&A roster.

Our first question comes from the line of Oliver Chen with Cowen & Company. Your line is open.

**Female Speaker:**

Hi, this is (inaudible) in for Oliver. Thank you for taking our questions. Just in terms of your credit review, if possible, could you just elaborate more on what has given you more comfort around the option of out-sourcing your credit business and viewing it as the preferred option versus keeping it in-house?

**Michele Santana:**

Sure. So, as I mentioned on the call and I described, we're looking at the out-sourcing alternative. We've identified that we would work with a primary and a secondary lender. So that gives us our view in terms of a potential path for outsourcing.

**Female Speaker:**

Okay, just to clarify, it's more about the structure?

**Michele Santana:**

It's the structure (inaudible).

**Female Speaker:**

Okay. Thank you.

**Operator:**

Your next question comes from the line of Lorraine Hutchinson with Bank of America. Your line is open.

**Lorraine Hutchinson:**

Thank you. Good morning. Mark, I was wondering if you had any numbers around the private jeweler closures that you could share with us? It seems like that's been a big factor in sales. Then also, for Michele, is there an opportunity to reduce expenses at this point, given the expectation for sales declines? Thanks.

**Mark Light:**

Thank you, Lorraine. As it relates to the jewelry store closures, according to the Jewelers Board of Trade, there was an increase of stores that were ceasing operations in the fourth quarter of 52% year-on-year. It was also stated by the Jewelers Board of Trade that is the biggest decrease of store closures—or biggest increase of store closures since the recession. I don't have the number at the top of my head, but I believe it's around 1,200 stores that closed year-over-year.

**Michele Santana:**

Yes, and to your second question in terms of the expenses, absolutely. That is what Management does, we focus on our expenses, and that's factored into our guidance. You can look at our results for Fiscal Year 2017. Our total sales declined \$156 million on an adjusted basis, but our EBIT was virtually flat. So, we do have the lever of expenses.

**Lorraine Hutchinson:**

Thank you.

**Michele Santana:**

You're welcome.

**Operator:**

Your next question comes from the line of Simeon Siegel with Nomura Instinet. Your line is open.

**Simeon Siegel:**

Thanks. Good morning, guys.

**Michele Santana:**

Good morning.

**Simeon Siegel:**

Michele, can you contextualize—I know you spoke about it a bit, but can you just help contextualize your comfort in that gross margin leverage, just despite the negative comps and I think you guys are lapping some impressive cost synergies? Then just a quick clarification. Just looking at the 165-plus closings, are you planning to close all the regionals this year, and any help on the timing of the closures and openings?

**Michele Santana:**

Sure. I'll take your first question on the gross margin and our level of comfort. I had mentioned on the prepared remarks the Zales gross margin rate increase, and that was driven primarily on the heels of a 120 basis point increase in the gross merchandise margin rate. So, we have confidence in the initiatives that Mark outlined, that are really focused on gross margin, repair, discounting, we're getting the cost savings from our vendors that are moving through our profit line based on our inventory turns. So, we feel confident in terms of our initiatives around gross margin and the ability to leverage on that gross margin as we look out into next year.

In terms of the regionals, we will still end the year with some regionals. We will accelerate, as Mark and I had alluded to on the call, this year, but there will still be a small residual that is left at the end of FY18.

**Mark Light:**

Simeon, if I could add, the majority of those stores will close by the end of the year because most of those leases terminate by the end of the year, and the regional stores that will be staying open are very profitable regional stores and we're not accustomed to closing profitable stores. So, that's why those stores will be open by the end of the year.

**Simeon Siegel:**

Great, thanks, and then, Mark, just to the point about the e-com channel growth, so when you think about that, are there differences you're seeing between bridal and the rest of the business?

**Mark Light:**

Well, yes. As it relates to our business, the bridal penetration of e-commerce is lower than we sell in our brick-and-mortar stores. We do sell lower price point items more on e-commerce. But that being said, Simeon, we see opportunities of gaining momentum on the bridal business. I mentioned we'll be testing a bridal configurator that we think will enhance the bridal experience on e-commerce. But, yes, there is a difference. Bridal penetrates much more in the stores than it does online has to date.

**Simeon Siegel:**

Great. Thanks a lot, guys.

**Mark Light:**

Thank you.

**Operator:**

Your next question comes from the line of Brian Tunick with Royal Bank of Canada. Your line is open.

**Brian Tunick:**

Thanks. Good morning, everyone. I have two questions. I guess, Mark, from your perspective, you keep calling out the mall traffic declines, and obviously, it sounds like February was down almost 10% for mall traffic. Is your customer telling you that they're not coming in and doing research anymore online and it's more of an impulse item? I'm just curious why you think that jewelry purchase has changed so much and why you're calling out mall traffic.

Then on Michele's point, I think you mentioned on the credit sale there would be an update or an impact on the share count. Is it wrong to think that if you were to go through a credit sale that you would look for an earnings-neutral deal and you would use the proceeds to buy back stock?

**Michele Santana:**

Let me just start with that and I'll flip it over to Mark to talk about the online. I guess two comments. One, it wouldn't be wrong to think that way but it's premature for us to comment on that. At the time we make the decision, we will update you in terms of any impact on what that means for our share count and share buybacks related to that.

**Mark Light:**

Yes, Brian, as it relates to jewelry shoppers, we know, and we've surveyed this heavily, the vast majority of jewelry shoppers go online first to educate themselves about our business, to educate themselves about diamonds—it's a product a lot of consumers just don't understand. So, we believe that shopping traffic is declining in the jewelry category as well because of going online first to educate themselves. We can't escape that the mall traffic is down, because we do have a lot—half our business is gift-giving business and that is affected as well by mall traffic. That being said, we're going to make tremendous enhancements to our online and omnichannel experience that we think will benefit our store brands both online and in-store.

**Brian Tunick:**

Great. Thanks and good luck.

**Mark Light:**

Thank you.

**Michele Santana:**

Thank you.

**Operator:**

Your next question comes from the line of Ike Boruchow with Wells Fargo. Your line is open.

**Tom Nikic:**

Hey, good morning everyone. This is Tom Nikic on for Ike. I kind of wanted to just ask about general category trends. I know that your comps have been negative for a couple of quarters now, and some of the department stores have talked about doing better in fine jewelry and making that a focus. Can you just kind of talk about broader kind of trends in the jewelry industry and maybe what the competitive set is looking like? Thanks.

**Mark Light:**

Yes, as it relates to the competitive set, Tom, as we've stated, it was a very promotional fourth quarter and, quite frankly, the first part of this year. A lot of our department store competitors did heavy, heavy discounting, specifically in the jewelry category, and we just elected not to participate and cut our margins to that level. As I stated earlier, there was a tremendous increase of independents and store closures, one of the largest increase of store closures since the recession, and a lot of those independent jewelers were having liquidation sales and discounting products very, very much, and, again, we decided not to participate and preserve our margin.

That being said, over the years, the jewelry industry, as we said, has been resilient. There have been dips in the industry and have seen the recovery, as Signet has done, on a consistent basis. We believe, with all the investments we're putting in technology and innovation of new product, and working on our marketing and digital marketing, that we still believe long term that Signet has a great opportunity of capturing profitable jewelry market share.

**Tom Nikic:**

All right. Thanks for taking my question. Good luck this year.

**Mark Light:**

Thank you.

**Operator:**

Your next question comes from the line of Scott Krasik with Buckingham Research. Your line is open.

**Scott Krasik:**

Yes, hi everyone. I'm just going to try and sneak three quick ones in first. So, Michele, first question, if you did have to keep the credit in-house and transition to contractual accounting, would that assume that you would have to have a material change in the penetration level of credit sales? Number two, it seems like you have about \$0.30 in transitory costs or expenses in your guidance for Fiscal 2018. Do those go away in Fiscal 2019? Then, number three, do we take the convertible—or the preferred dividend out of net income, or because it's assumed in the share count, is it not included in the calculation for EPS? Thanks.

**Michele Santana:**

Okay. So, you did, you snuck in three quick questions. Yes, I guess your first question, in terms—if you assume that we wouldn't be successful in an outsourcing scenario and moving to a contractual, it really has no implication in terms of the credit penetration rate. I'm not sure if I fully understand what you were trying to get at there, but there's nothing that I'm aware of that would have indication on our credit penetration.

Secondly, the \$0.30, you're correct. It's about an implied \$0.30 of purchasing accounting and integration costs in FY18 that's factored into the guidance. When you think about FY19, some of those costs will go away. Keep in mind, with purchase accounting, that actually will drag on for a period of time. Primarily, it's with the deferred revenue, but it will continue to be lessened as we move past FY 18.

The third question, Scott, you had on the convertible, that's factored both into our numerator and denominator on how you calculate your earnings per share. So, I think you're fine in terms of probably how you're looking at it.

**Scott Krasik:**

Okay. Thanks so much.

**Operator:**

Your next question comes from the line of Janet Kloppenburg with JJK Research. Your line is open.

**Janet Kloppenburg:**

Good morning, everyone. Mark, I wondered if you could talk about the particulars of the fashion jewelry business, some of the lower AUR businesses that you met with some promotional activity from competitors and lost some share, what's the outlook there for that business as we go forward? I think it's great that you're trying not to promote much, but if the pricing pressure continues, I'm just wondering how far you'll let market share erosion go in light of pricing pressure. Thank you.

Also, Michele, could you talk about inventory levels and, if they're aligned by brand, where they should be? Thank you.

**Mark Light:**

Thank you, Janet. As it relates to fashion jewelry, when we analyzed our results from the Christmas sales, we saw that there were certain price points in fashion, lower price points, call it \$200 to \$700, that we did not do as well as we expected to do. Our Merchandising team is very focused on finding key fashion trends and testing key fashion trends in those price points, and we are focused right now on testing some different products and programs and brands in those price points, and we believe that we will have the opportunity to gain that market share back in those price points. What we did in the fourth quarter didn't connect with the consumers. We'll learn from that we'll take our learnings and make sure that we do much better in those price points for this year, and going into the fourth quarter of this year, also.

**Michele Santana:**

Janet, if I could just add on to what Mark said, just to understand the comments in terms of our expectations to leverage gross margin next year, that also includes that we anticipate there will be promotional activity for Signet this year. So, it's all netted into our guidance.

**Mark Light:**

Thank you, Michele. One other thing, Janet, I want to make sure is clear. We're also much more focused this year. There was a dynamic shift on what was happening in the jewelry industry and we're focused much more on women customers, specifically, and specifically fashion-orient products that are attractive to women. So, it's something that we're very focused on. We'll be doing a lot of testing and research on those fashion products.

**Michele Santana:**

Janet, I'll hit your second question related to inventory, which I believe is inventory aligned by brand. We still have a continued opportunity with our Zale banners to optimize our inventory levels and that will continue to be an ongoing initiative, to drive a faster inventory turn rate.

**Janet Kloppenburg:**

Thank you.

**Michele Santana:**

Thank you.

**Operator:**

Your next question comes from the line of Dana Telsey with Telsey Advisory Group. Your line is open.

**Dana Telsey:**

Good morning. Can you talk a little bit about the store closures that you're doing? What do you see is the impact sales and profit? And the investment in omnichannel, what should we—how much will it be of the cap ex and what should we see coming through to the holiday season this year? Thank you.



**Michele Santana:**

All right. So, your first question in terms of the impact of the store closures on sales and profit, the stores that we're closing and accelerating we actually believe will have a benefit to our existing mall stores when we look at sales transference, and it should only actually help to strengthen our top line and our profit for this year.

I missed the second part of that question.

**Dana Telsey:**

The investment in omnichannel. Can you take us through what initiatives should we be looking at this year in order to wind up the holiday season a better holiday than 2016.

**Mark Light:**

Yes, there's several initiatives that I said in my prepared comments. Let me just get my notes here a second. We are investing specifically in digital marketing and we are investing in enhancing our architecture, that we believe will enhance our customer content review. We are investing in making sure—heavily in the Zales platform. We're actually putting Zale—because their platform is a platform that does not have a future, so we're investing heavily in a new platform, which is a hybrid platform for our Zales brand. There's a lot more invested and we can talk about it in more detail, Dana, off the call, but we're investing in digital marketing, we're investing in a huge new platform for Zale, and we're investing in the architecture to get it corrected for our Sterling brands.

**Dana Telsey:**

Got it, and just a quick question, more color on the Mother's Day shift. Is advertising moving, or the different date, May 8 last year and May 14 this year, anything we should take away on Mother's Day, given the earnings impact of what's changing?

**Michele Santana:**

Yes, I think I said—you saw it in the release and I mentioned on the call. What I would say is that there's shift out of Q1 into Q2 of about 300 to 350 basis points as it relates to sales, and the EPS number I gave you would also factor in any movement on the advertising side, as well.

**Dana Telsey:**

Thank you.

**Michele Santana:**

Thank you, Dana.

**Operator:**

We are out of time for further questions. At this time, I will now turn the call back to Mr. Light.

**Mark Light:**

Thank you all for taking part in this call. Our next scheduled call is to report the first quarter of Fiscal 2018 is on May 25. Thanks again everybody, and good-bye.

**Operator:**

Thank you. Ladies and gentlemen, this concludes today's call. You may now disconnect.