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# Signet Jewelers Ltd. (SIG)

Q1 2019 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Ladies and gentlemen, thank you for standing by. Welcome to the Signet Jewelers Limited First Quarter 2019 Results Conference Call. During the call, all participants will be in a listen-only mode. After the prepared comments we will conduct a question-and-answer session. Instructions will be provided at that time. [Operator Instructions] Please note that this call is being recorded today, June 06, 2018, at 8:30 AM Eastern Time.

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

## Randi Abada
*SVP Corporate Finance Strategy & Investor Relations, Signet Jewelers Ltd.*

Good morning and welcome to our first quarter earnings conference call. On the call today are Signet's CEO; Gina Drosos; and CFO Michele Santana. During today's presentation we will in places 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 and quarterly reports on Form 10 Q.

Except as required by law we undertake no obligation to revise or publicly update forward-looking statements in light of new information or future events. During the call we will discuss certain non GAAP financial measures. For a discussion of the non GAAP financial measures as well as reconciliations of the non GAAP financial measures to the most directly comparable GAAP measures, investors should review the press release we posted on our website.

I'll now turn the call over to Gina.

## Virginia C. Drosos

*Chief Executive Officer & Director, Signet Jewelers Ltd.*

Good morning everyone and thank you for joining today's call. Today Michele and I will discuss Signet's first quarter which has a number of complexities impacting our results, as well as update you on our early actions under our Path to Brilliance plan. We will then open the line for your questions.

As discussed last quarter, our Path to Brilliance plan is designed to increase our cost competitiveness by driving out costs customers do not see or care about, while enabling growth investments in our eCommerce and OmniChannel capabilities, product and digital innovation, customer value and optimizing our real estate footprint.

This plan, which is focused on three pillars: Customer First, OmniChannel and Building a Culture of Agility and Efficiency is intended to reposition Signet to be a share gaining OmniChannel jewelry category leader. While we are only two months into our 3-year transformation plan, we've initiated a number of steps to build a strong foundation. Later on I'll spend time discussing some of these initiatives.

Q1 showed signs of stabilization, with same-store sales and earnings performance ahead of our guidance and we saw sequential improvement across the majority of our core banners.

Additionally, with an intense focus on creating a seamless OmniChannel experience, we once again achieved double digit growth in eCommerce. We continued to see green shoots at Zales and Piercing Pagoda, which both achieved high single digit same-store sales growth in the quarter and improved sequentially over a strong fourth quarter.

Our results at Kay also improved sequentially, reflecting some benefit from planned promotions, as well as meaningful improvement in credit execution in our stores. We injected significant newness and focused on key brand propositions in the quarter, leading to North America same-store sales up 0.6%, which included the positive impact of James Allen sales growth.

At the category level in North America, Fashion, Bridal and watch sales each increased, while beads declined as we strategically reduced our participation in our owned brands including Charmed Memories and Persona. Bridal and Fashion each had a higher percentage of new products in the quarter, which helped drive sales growth.

Bridal performance also benefited from strength in solitaires, Enchanted Disney, Neil Lane and Vera Wang Love collections, partially offset by declines in Ever Us. Fashion had strong performance in gold jewelry items and fashion rings.

In the International division, which comprises our UK operations, overall macro conditions were unfavorable with continued declines in nonfood consumer spending. In our business we saw lower sales of diamond jewelry and fashion watches, somewhat offset by higher sales in prestige watches.

As I mentioned, we continued to improve our eCommerce capabilities with strong sales in the quarter up 81% on a reported basis. We saw growth in eCommerce across all banners in the quarter, led by James Allen which grew 29%.

As you know, as part of our efforts to focus on our core business, reduce risk, and lower our working capital needs, we began to transition to an outsourced credit model late in the third quarter of fiscal 2018. Upon conversion we experienced some transition related issues that impacted same-store sales.

We've implemented a comprehensive action plan to return to operational excellence and offering credit to our customers and we are seeing signs of stabilization versus the pre-outsourcing trend in the application volumes.

We estimate that the negative impact of the credit transition issues on our total same-store sales was approximately 100 basis points in the first quarter, which is a significant improvement versus the approximately 300-basis point impact in the fourth quarter of fiscal 2018.

While we believe that the issues related to the outsourcing are mostly behind us, we expect there may be some remaining sales impact related to the transition in our second and third quarter sales results. Going forward, our credit volumes and participation rates will continue to be subject to overall consumer health and mall traffic trends. We remain focused on providing category leading payment options for our customers and working to improve the application volumes and participation rates.

Now I'd like to discuss how our Signet Path to Brilliance transformation plan is coming to life strategically to reposition our business. In order to measure our progress and hold ourselves accountable as we move through this plan, we are working towards establishing baselines over the remainder of fiscal 2019, so that we can provide you with additional metrics to evaluate our progress going forward.

So beginning with Customer First. We're in the late stages of completing our new brand repositioning work, to clearly differentiate our North America banners, Kay, Zales and Jared to better align with individual target customers and unique value propositions.

The new positionings, which are informed by consumer research and feedback, will be rolled out for this holiday season and fully supported by an integrated marketing campaign. We look forward to discussing them with you later this fall.

We continued to focus on increasing both core and disruptive innovation. In fiscal 2019, new product tests are increasing year-over-year and we have improved our idea screening process to focus on the highest scoring ideas more quickly. We have also launched our innovation engine, which is responsible for idea generation, qualification, piloting, and ultimately implementing the best ideas across disruptive customer experiences and business models.

As I have previously discussed, we are investing in data analytics and building strategic partnerships to further enhance our personalized marketing capabilities. The highly successful Enchanted Disney collection is now being featured on the Disney Digital Network to drive further sales.

We also recently expanded our relationship with ADS to leverage its digital marketing platform and data services to personalize and more efficiently target customers at each step in their journey, ensuring that they have a best-in-class, fully connected in-store and online experience.

For example we are currently using this relationship in the campaign targeting parents, with students who are graduating high school and college, encouraging them to commemorate these important events by gifting their child's first diamond jewelry.

Additionally, our customer experience team recently began launching a Net Promoter Score initiative to track customer experience performance and synthesize feedback into actionable insights. This capability will enable us to measure all North America banner stores, as well as our online business, integrating with existing store and customer care systems.

We will measure our progress under Customer First initiatives, in terms of same-store sales and newly implemented customer Net Promoter Score performance once fully deployed. The initial launch is running ahead of our expectations and is scheduled to be live in all core banners later this month.

Our initial efforts will establish the baseline scores by mid fiscal 2020, allowing us to track performance trends as we move through the second half of fiscal 2020 and beyond.

Turning to OmniChannel. As we discussed last quarter, we are working to seamlessly integrate the online and in-store experience, enhancing our eCommerce and OmniChannel capabilities is a key aspect of our Path to Brilliance plan and we continue to see encouraging results from the new initiative we have already implemented in this area.

We are focused on driving double digit growth in eCommerce sales with the goal of increasing eCommerce as a percentage of total sales from 8% in fiscal 2018 to at least 15% in fiscal year 2021. While early in our journey, we are making good progress to achieve this goal as eCommerce was almost 10% of total quarterly sales and we achieved increases in both traffic and average order value in the first quarter.

We continue to see positive results from several initiatives in OmniChannel, such as website appointment booking and product visualization. Here are a few highlights. During the quarter we booked over 7,500 appointments via our website, more than doubling the bookings in the fourth quarter.

In terms of product visualization, we have increased the numbers of products shown on a model and continue to see double digit increases in conversion rates with those items. Additionally, the ability to view local store inventory online is now live at Zales. This is in addition to the Kay and Jared banners, which launched this feature in the third quarter of fiscal 2018.

We continue to leverage the digital innovation capabilities of R2Net with Segoma visualization and Ring Try-On capabilities expanding at Jared and in development at Kay. Customers will begin seeing these efforts across top selling ring designs at Kay in the second half of the fiscal year. In addition, we are continuing to pilot and optimize a digital innovation program in Jared stores, where we are making over 100,000 diamonds available to customers through a virtual diamond vault, leveraging R2Net visualization and diamond market technology.

Finally this fall, we will be launching the ability for customers to sign in to the Kay, Zales, and Jared websites using Facebook or Google credentials, which will enhance the customer experience through a faster checkout process and is expected to drive higher conversion.

In OmniChannel, we will continue to measure success looking at both eCommerce sales growth and eCommerce as a percentage of sales. Moving onto Culture of Agility and Efficiency. A key component of our 3-year transformation plan is to drive out costs customers do not see or care about in order to lower our cost base and provide funds for reinvestment in growth drivers and enhanced profitability.

We continue to expect net cost savings of $200 million to $225 million over the course of the 3-year plan with $85 million to $100 million of the target delivered in fiscal 2019. As we have mentioned, the fiscal 2019 net cost savings are more heavily weighted to the fourth quarter.

Our initiatives are structured to provide both cost of goods sold and SG&A savings, with fiscal 2019 savings more heavily weighted toward SG&A as sourcing efforts typically take longer to be reflected in the financials.

SG&A efforts include partnering with a leading retail consultant on indirect spend savings as well as lowering corporate costs and non-store facing IT expenses. Our cost of goods sold initiatives are focused on product sourcing, freight optimization, and distribution center efficiencies and consolidation. We also continue to focus on transforming our real estate strategy.

Our goal is to provide new and compelling in-store customer experiences and drive seamless integration between our stores and our eCommerce platforms, resulting in higher sales productivity per store. We have begun the process of streamlining and repositioning our store footprint with the goal of achieving at least 30% sales transference from planned store closures to other Signet banners.

As always, we will be opportunistic and disciplined in new store openings, focusing on off-mall locations and desirable markets and obtaining favorable lease terms. We continue to expect closing more than 200 stores in fiscal 2019 and expect our store count at the end of our transformation plan to be lower than year-end fiscal 2019.

We will measure our progress on cost reductions, productivity metrics and asset utilization through improvement in our return on invested capital. Beyond the financial investments we are making, as part of our Agility and Efficiency efforts, we have made a commitment to shift the culture of the company to increase accountability and speed up decision-making.

We are constantly working to identify, recruit, and deploy the best talent. In this regard, last quarter we reorganized to a North America structure from a Sterling and Zales structure. Each of our major North America banners will have its own general manager, with functional leaders across marketing, store operations and merchandising, supporting all banners.

In an effort to further strengthen our functional teams we recently hired additional merchandising talent. We believe these organizational changes will enable greater focus on the customer, increased accountability and improved product assortment and newness.

Having the right leadership in place is critical to successfully implementing Path to Brilliance. As you saw in today's press release, we have further strengthened the Signet leadership team with two new hires: Chief People Officer, Mary Liz Finn; and Chief Supply Chain Officer, Steve Lovejoy.

They joined recently hired Chief Information Officer Howard Melnyk; and Chief Communications Officer Carol Schumacher. Along with Lynn Dennison as our Chief Transformation Officer, who has taken on additional responsibilities for strategy and innovation.

Mary Liz led Nielsen through a major transformation and brings the visionary thinking, operational excellence and people first mindset that will help us achieve our vision of a highly engaged, diverse and inclusive culture and become a consistent best workplace.

Steve has previous experience in retail and consumer goods from his time at Starbucks and Clorox. His breadth and depth of both international and domestic supply chain knowledge is something we plan to leverage to drive our Agility and Efficiency priorities within our supply chain organization.

I am confident Mary Liz and Steve will add diverse leadership capabilities and experiences to the leadership team and the functions they will lead and I'm pleased to welcome them to the Signet team. And let me say a quick word about culture.

It's incredibly important at Signet that we create a workplace that will allow us to continue to attract, retain, and advance great people and that we have a culture that encourages and rewards winning performance.

We have to make sure we have the right culture in place to make decisions more quickly, think more creatively and to work more efficiently, all to ensure that we're as responsive as possible to our customers' changing desires and habits.

We still have work to do in this area, but some recent examples of our cultural transformation include: The completion of a comprehensive evaluation of all transformation and innovation initiatives to drive focus of our resources on the highest potential ideas; and roll out of several projects to streamline non-customer facing work to allow our store team members to spend more of their time with customers, while increasing store productivity. Through technology and process enhancements we have reduced approximately 50 hours per month in our mall stores and over 100 hours per month in Jared.

We are also continuing to implement our culture action plan, which is designed to further strengthen the training, development and advancement opportunities of all team members and promote fresh and diverse perspectives. Our refreshed core values were developed with team member input and have been deployed across the organization along with enhanced internal communications. I'm also particularly proud of the recent diversity and inclusion workshop we conducted with all of our store managers and field leadership.

Our 36,000 talent and hard working team members are our greatest strength and we will continue to support and empower them to drive our future success.

Turning to our guidance, for fiscal 2019 we continue to expect same-store sales down low to mid single digits. As a reminder, in the second quarter we have a much more challenging same-store sales comparison versus the prior year and a negative impact from a calendar shift, which impacted timing of promotions.

Our Path to Brilliance innovation and marketing plans will continue to ramp up as we move through the year, but it will take time for our efforts to show up in our financial results. We expect gradual and incremental improvement over the course of our plan and we'll be in a better position to share a longer term outlook for same-store sales after the key holiday season.

We are reiterating our fiscal 2019 non-GAAP EPS guidance of $3.75 to $4.25. This guidance includes the outperformance versus our plan in the first quarter, our latest projections for the impact of share repurchase and incremental costs related to outsourcing credit.

Importantly, as a reminder, we are only two months into implementing our transformation plan and expect to earn the vast majority of our operating profit in the fourth quarter. Our guidance continues to expect the sale of our book of non-prime receivables to close in the second quarter.

This credit transaction, in conjunction with the prior outsourcing of our prime receivables to ADS, will complete Signet's transition to a fully outsourced credit structure, while maintaining a full spectrum of category-leading financing options for customers.

Turning to capital allocation, we plan to remain highly disciplined with the majority of free cash flow being returned to shareholders in the form of dividends and share repurchases. Our Board of Directors recently raised our dividend per share by 19%, representing our seventh consecutive annual dividend per share increase. Additionally, proceeds from the credit transactions, as well as cash on hand are enabling significant share repurchases. We continue to expect repurchases of $475 million in fiscal 2019 and we completed $60 million of this target in the first quarter.

In fiscal 2019 alone, we expect to repurchase more than 15% of shares outstanding. Over a two-year period encompassing fiscal 2018 and 2019, more than 25% of Signet's outstanding shares will have been repurchased.

In conclusion, we are confident that Signet is working from a strong foundation and is on the right path to create long-term profitable growth. Over time we expect to see incremental improvement across our business as we continue to execute on our Path to Brilliance transformation plan.

With that, I'll pass the call to Michele for more details on our financial results.

## Michele Santana

*Chief Financial Officer, Signet Jewelers Ltd.*

Thank you, Gina, and good morning, everyone. I'll start with a review of our first quarter results. After that I will provide an update on the sale of our non-prime accounts receivable, the financial impacts of our transformation strategy and lastly, discuss our updated guidance for fiscal 2019 and our outlook for the second quarter.

For the first quarter, total sales were $1.5 billion, up 5.5% year-over-year on a total basis and 4.3% on a constant currency basis. Same-store sales growth was essentially flat to prior year including an 85-basis point benefit from James Allen. James Allen generated a total of $53 million in revenues in the first quarter.

Additional items which did not impact same-store sales, but had a favorable impact on total revenue dollars included the following three items: First, the adoption of the new revenue recognition accounting standard, which contributed $24.5 million in sales; second, a calendar shift of weeks in the quarter which resulted in a Mother's Day event in Q1 that was held in the second quarter of the prior year. Note that this shift has no impact on same-store sales as same-store sales calculations were adjusted to comparable weeks. The net effect of realigning the weeks, following our 53rd week fiscal year including the Mothers' Day shift was $16 million. Third, a foreign exchange benefit of $16 million. Offsetting these favorable impacts were a negative impact of store closures of $39 million.

Within the North America segment, same-store sales momentum in our Zales and Piercing Pagoda banners continued with growth of 8.9% and 7.2% respectively. Kay same-store sales improved sequentially at down 1.9%, which included 430 basis points of benefit from a planned promotional guest appreciation event out of Q4 into Q1 to align closer to Valentine's Day.

Jared same-store sales were down 7.8% including a negative impact of 180 basis points due also to a planned promotional move out of Q1 into the second quarter to align closer to Mothers' Day. The gross margin rate was 32.7% in the quarter, down 230 basis points year-over-year. The gross margin rate decline was anticipated in our guidance and reflects certain factors that are more pronounced in the first quarter and will have less of an impact as we move through the balance of the year.

The overall rate decline was driven by the following five items. First, our gross margin rate results reflect our previously announced decision to cease offering credit insurance mid-year in fiscal 2018. The impact of the credit insurance of 70 basis points in the first quarter will be less of a headwind as we move through the balance of fiscal 2019 due to the timing under which we phased out this program.

Second, the impact of addition of James Allen, which carries a lower gross margin rate negatively impacted the rate by 60 basis points and also becomes less impactful once we lap the acquisition in September. Third, bad debt expense had a negative impact of 50 basis points on rate.

Although, only two months of bad debt expense were reported in the first quarter as compared to a full quarter in the prior year, we saw a higher level of expense primarily attributed to a lag effect of conversion disruption that occurred in last November and December, resulting in higher losses.

Fourth, to a much lesser extent the gross margin rate was impacted by a negative 20 basis points due the calendar shifts of promotions in the first quarter. And then lastly, a smaller unfavorable impact of 10 basis points, related to adoption of the new revenue recognition standard. As always a critical driver of leverage in our gross margin rate as we move ahead will be same-store sales performance.

SG&A expense was 32.6% of sales in the quarter, compared to 32.3% in the prior year quarter. Total SG&A dollars were up by $30 million over the prior year quarter, which includes R2Net/James Allen SG&A. The primary drivers of increased SG&A were $12 million in higher advertising, $24 million credit outsourcing cost, which was partially offset by $12 million in savings related to in-house credit operations and $9 million in higher incentive compensation, which included a one-time $6 million cash award to non-managerial [ph] R2Net (28:23) team members and to a lesser extent foreign exchange. These increases were partially offset by transformation cost savings.

Other operating income declined by $55 million as expected compared to prior year due primarily to a loss of interest income as a result of the sale of our prime accounts receivable portfolio that occurred in the third quarter of fiscal 2018.

Our GAAP operating loss of $574 million included the following three items. First, we recorded a non-cash goodwill and intangible asset impairment pre-tax charge of $449 million in the quarter, which will have no impact on the company's day-to-day operations or liquidity. The charge is primarily related to the write down of goodwill and intangibles recognized as part of the Zale Corporation acquisition. This includes goodwill and indefinite lived intangible assets, as well as goodwill associated with the acquisition of Ultra Stores, Inc.

The decline in our market capitalization during the first quarter created a triggering event for impairment assessment purposes. As part of the assessment, it was determined that an increase in the discount rate applied in the valuation was required. This higher discount rate in conjunction with revised long-term projections associated with finalizing certain initial aspects of our Path to Brilliance plan in the first quarter resulted in lower than previously projected long-term future cash flows for these businesses, which required an adjustment to the goodwill and intangible asset balances.

Second, as expected we recognized the loss of $143 million on non-prime receivables, which were reclassified to held-for-sale during the quarter in advance of the closing of the non-prime credit outsourcing transaction.

And third, we incurred restructuring charges of $6.5 million related to severance and professional fees associated with our transformation plan.

On a non-GAAP basis, excluding these items, operating income was $24 million or 1.6% of sales, which was ahead of our plan as a result of better than expected same-store sales performance, partially offset by higher than expected credit outsourcing costs.

The total impact in Q1 related to credit outsourcing was $69 million, compared to our previously guided estimate of $60 million. The higher than expected credit cost in the quarter were primarily driven by higher bad debt expense and higher prime tender cost due to a higher mix of customers electing deferred interest plans over revolving plans. We anticipate that this trend of mix will continue in the current year and therefore have updated our expectations related to these costs that I will discuss as part of our fiscal year 2019 guidance momentarily.

And looking year-over-year the decline in operating margin rate of 660 basis points was primarily driven by a 600-basis point decline attributable to the net combination of credit outsourcing and discontinuation of credit insurance. Additional drivers included higher average pricing and incentive compensation somewhat offset by greater sales leverage and cost savings.

GAAP EPS was a loss of $8.48 including $6.44 charge related to goodwill and intangible impairment, a $2.05 impact related to the loss on the reclassification of non-prime receivables and $0.09 of restructuring charges associated with the transformation plan. Excluding these charges, non-GAAP EPS was $0.10 for the quarter.

So let me briefly touch on our credit participation rate in the first quarter. We are now reporting credit participation on a North America segment basis, which includes the legacy Zale Division in addition to our legacy Sterling Division. As we'll be including lease purchasing into this ratio, our credit participation rate will be referred to as the payment plan participation rate going forward. North America payment plan participation inclusive of leasing in the first quarter was 49.7% versus the prior year quarter of 53.4%.

In closing out my first quarter comments, free cash flow was flat year-over-year with lower operating cash flow offset by lower capital spending as we reduce our store base. We repurchased $60 million in Signet shares during the first quarter at an average price of $39.62 as part of our previously announced $475 million expected share repurchase in fiscal 2019.

Now turning to an update on the sale of our non-prime receivable portfolio and the overall financial impact on our operating profit related to the outsourcing of both the prime and non-prime portfolio. We continue to expect the sale of the receivables to close in the second quarter and this timing is embedded in our fiscal 2019 guidance.

We now expect $420 million to $435 million in proceeds at closing compared to $401 million to $435 million previously guided. This is driven by a higher expected receivable balance and we continue to expect $7 million of transaction costs. Net proceeds from the transaction will be used for share repurchases in fiscal 2019 subject to market conditions.

As I shared on the fourth quarter call, we expect to book a total pre-tax loss associated with the sale of the non-prime receivables of approximately $165 million to $170 million of which $143 million was recognized in the first quarter with the remainder to be recognized in the second quarter. In terms of the expected financial impact of our credit outsourcing in totality, we previously provided an estimate of the negative year-over-year impact on operating profit of $118 million to $133 million for the full fiscal 2019 year.

We now expect full year fiscal 2019 operating profit to be unfavorably impacted year-over-year by $145 million to $155 million. This increase is driven by our first quarter results and higher fees on our prime credit portfolio for the balance of fiscal 2019 related to a higher mix of deferred interest plans. The year-over-year impact is expected to be $32 million to $35 million in the second quarter, $40 million to $45 million in the third quarter and $4 million to $6 million in the fourth quarter.

For fiscal 2020, we continue to expect year-over-year impact on operating income ranging from zero to a benefit of $5 million. So fiscal 2020 estimates incorporates scheduled significant increase in revenue share profit percentage related to our prime outsourcing arrangement, as well as a comparison against one quarter of bad debt expense in fiscal 2019.

Our projected fiscal 2020 expense also includes an assumed discount rate for the non-prime arrangement. The fiscal 2020 estimate could change if the discount rate were to reset higher or lower under certain review provisions in the non-prime receivables agreement.

So with that, let me move to review financial considerations associated with our transformation plan. We continue to expect the Path to Brilliance plan to result in net cost savings of $200 million to $225 million over three years. In fiscal 2019, the transformation plan is expected to deliver net cost savings of $85 million to $100 million with further incremental cost reductions of $115 million to $125 million by the end of the 3-year program.

As we previously guided, the majority of cost savings in fiscal year 2019 are expected to be realized in the fourth quarter. Total charges are anticipated to be $170 million to $190 million over the 3 years with $125 million to $135 million of charges in fiscal 2019. Cash charges are anticipated to be $105 million to $120 million, of which $60 million to $65 million are expected to be paid in fiscal 2019.

Lastly, before moving onto guidance and capital allocation, our fiscal 2019 total revenue guidance is unchanged at $5.9 billion to $6.1 billion and we continue to expect same-store sales to be down low to mid single digits. As a reminder, we had an extra week in fiscal 2018, which provided $84 million in revenue. We also closed stores in fiscal 2018 that had revenue of approximately $150 million. Both of these amounts should be renewed from 2018 base when working through your models.

As I discussed earlier, we adopted the new revenue recognition standard this year, which is expected to result in approximately $100 million of revenue including in total sales dollar guidance with no impact on profit as this is simply a geography change on the P&L. The offsetting expense is 70% cost of goods sold and 30% SG&A. Our same-store sales guidance of negative low to mid single digits assumes the positive momentum we saw in our Zales banner in the first quarter to continue and to be offset by negative sales growth in our Kay and Jared banners.

Please note that our same-store sales excludes revenue recognition changes. As our transformation initiatives and product innovation plans begin to take hold, we do anticipate gradual signs of improvement in same-store sales trends in the fourth quarter.

So moving on to operating profit. Fiscal 2019 operating profit will be negatively impacted by the following four items. First, the impact of credit outsourcing discussed in my earlier comments; second a $50 million year-over-year increase related to compensation, primarily driven by the restoration of short-term incentive compensation that did not pay out in fiscal 2018. Third, the discontinuation of credit insurance; and fourth, deleverage of fixed cost due to lower sales. These headwinds are somewhat offset by expected net cost savings of $85 million to $100 million related to our transformation plan.

Our non-GAAP EPS guidance of $3.75 to $4.25 is unchanged and reflects first quarter outperformance and updated share repurchase assumptions offset by higher credit outsourcing impact. In addition our non-GAAP EPS guidance embeds a normalized tax rate of 8% to 10%.

Our GAAP EPS guidance of a loss of $7.30 to $7.90 includes the impairment charge recorded in the first quarter, the loss related to the sale of non-prime receivables and restructuring charges related to the transformation plan. In addition, the GAAP EPS guidance includes an estimated tax benefit of $95 million to $115 million driven by the anticipated charges that I just discussed.

In addition, we have provided both common basic shares and diluted shares as part of our guidance. For purposes of calculating both GAAP and non-GAAP EPS, we expect to use the basic share count for the first, second, third quarters and full year due to the projected level of net income. For the fourth quarter only, diluted share count should be used in modeling EPS.

Given complexities in modeling, we are also providing additional information on the second quarter including guidance for total sales, same-store sales and EPS. We expect total sales of $1.3 billion to $1.35 billion, same-store sales are down mid-single digits and non-GAAP EPS of $0.05 to $0.20.

Our same-store sales outlook incorporates a more difficult prior year comparison versus the first quarter and some continuing impacts from the outsourcing credit transition. In addition to same-store sales performance total sales guidance includes negative impacts of $50 million due to calendar realignment which moved a promotion into the first quarter fiscal 2019 that was in the second quarter in fiscal 2018 and $35 million related to previously closed stores. Total sales will be positively impacted by $25 million related to the adoption of the new revenue recognition standard.

As I mentioned earlier, gross margin rate in the second quarter will continue to be negatively impacted by the addition of James Allen and the discontinuation of credit insurance. We also expect deleverage of fixed cost due to lower sales. These unfavorable factors will be more than offset by a positive impact as we no longer recognize bad debt expense. All in, we do expect our gross margin rate to improve on a year-over-year basis in the second quarter.

SG&A is expected to reflect higher year-over-year advertising and incentive compensation expense and impact of cost related to our credit outsourcing. As previously mentioned, we estimate the credit outsourcing to have a negative $32 million to $35 million impact on operating income. This estimate includes the loss of finance income, no further bad debt expense and the cost of outsourcing credit.

As I noted for the second quarter, our non-GAAP EPS guidance is $0.05 to $0.20 and excludes expected restructuring charges related to our Path to Brilliance plan of $70 million to $75 million and residual loss related to the non-prime receivables outsourcing of $22 million to $27 million. GAAP EPS guidance including these items is a loss of $1 to $0.75.

We continue to expect the majority of our operating profit to be generated in the fourth quarter, which takes into consideration the following six factors. First, expected to improve same-store sales performance as transition issues in stores related to the outsourcing of credit improved and the benefits of the Path to Brilliance initiative begin to take hold.

Second, expected greater fixed cost leverage due to improve sales performance; third, less impact from negative margin mix versus earlier quarters due to James Allen being included in the fourth quarter of the fiscal 2018 base; fourth, net cost savings from Path to Brilliance more heavily weighted to the fourth quarter; fifth, smaller impact from the credit outsourcing transaction versus earlier fiscal 2019 quarters as we lap the outsourcing of the prime receivables book late in the third quarter; and finally sixth, fully lapping the discontinuation of credit insurance at the end of the third quarter.

We continue to expect to repurchase approximately $475 million at Jared's in fiscal 2019 funded primarily by the sale of non-prime receivables as well as cash on hand. With respect to leverage, we continue to expect to exceed the high-end of our 3 to 3.5 times target leverage ratio in fiscal 2019 as we begin our transformation, but expect to be back within that range before the end of the 3-year transformational plan.

That concludes my prepared remarks. And I'll now pass the call back to the operator to please open the line for questions.

# QUESTION AND ANSWER SECTION

**Operator**: [Operator Instructions] And your first question comes from the line of Brian Tunick with RBC. Your line is open.

Brian Jay Tunick
*Analyst, RBC Capital Markets LLC*

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Great. Thanks, good morning and nice to see some stabilization there. I was curious about the Kay business. Maybe you could give us some underlying metrics maybe you could look at from an internal perspective. I guess when we look externally at the shift in the promotion from Q4 and the credit outsourcing obviously a lot of noise there. Can you maybe give us sort of what you think are the key drivers whether it was transactions or average ticket on the Kay business? And then maybe the second question just how you're looking at the overall jewelry industry trends or any category growth you can comment on for Q1? Thank you very much.

Virginia C. Drosos
*Chief Executive Officer & Director, Signet Jewelers Ltd.*

A

Hi Brian. Thanks for your questions. So I'll start with a macro overview on Kay turn it over to Michele for some details on the specifics you asked and then I'll come back on the jewelry industry question. I think in a macro sense what we've seen on Kay in the quarter is a couple of things. One is improved operational excellence on our credit transition issues. We worked very hard to get a number of important initiatives in place in stores including retraining of our entire store staff around our different credit offerings and some important IT interventions. And this really helped us see some stabilization in that.

The second is a focus on innovation and bringing newness in merchandise to some of our core sub brands. We saw some really nice growth in Bridal behind Neil Lane, as an example, we've brought in significantly newer better merchandise we feel in Bridal and in Fashion and both of those grew for Kay in the quarter. So in a macro sense what we're seeing on Kay I think is the very beginning of Path to Brilliance initiatives starting to come to life.

Michele Santana
*Chief Financial Officer, Signet Jewelers Ltd.*

A

Yeah. I'll just add one additional comment to that, Brian. I know you mentioned the promotional shift that we talked about on the call. I mean, when you look at Kay's comp for the quarter are down 1.9% and factoring that promotional that we attributed 430 basis points to, it still showed strong sequential improvement over our Q4 period and the stabilization that Gina had talked on the call was evident driven by the initiatives.

Virginia C. Drosos
*Chief Executive Officer & Director, Signet Jewelers Ltd.*

A

I think on your question regarding macro jewelry trends, we see the category is healthy. You know data is hard to come by in this category but it appears that we're still continuing to see growth in that 3% to 5% range that we've seen over the last number of years, so that's great.

The biggest opportunity in my point of view is for a company like Signet to begin over our Path to Brilliance transformation to lead category growth as we access more events. I gave the keynote address at JCK, which is our big industry conference last week and I talked about the fact that instead of just focusing on Valentine's Day and Mother's Day and holiday, we have an opportunity to win more birthdays, more graduations, things like that throughout the year.

And I think the data analytics that I talked about on the call, how we're now able to target parents before graduation events we're able to target gift givers around birthdays and things like that those will continue to allow us to have more personalized and targeted messaging going forward. And hopefully be able to grow the category further.

Brian Jay Tunick
*Analyst, RBC Capital Markets LLC*

Q

That's great. Thanks and good luck.

Virginia C. Drosos
*Chief Executive Officer & Director, Signet Jewelers Ltd.*

A

Thank you.

Michele Santana
*Chief Financial Officer, Signet Jewelers Ltd.*

A

Thank you.

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

Irwin Bernard Boruchow Jr.
*Analyst, Wells Fargo Securities LLC*

Q

Hi. Good morning, everyone. Thanks for taking my question. I have two questions. And I wanted to piggyback off of Brian's. So the Kay improvement, much, much better. That's good to see. But Jared actually got worse despite the promo shift in Q1. Can you maybe just help us understand how you're feeling about Jared relative to all the things you kind of just said about Kay?

Virginia C. Drosos
*Chief Executive Officer & Director, Signet Jewelers Ltd.*

A

I think just on a high level in Jared it is lagging because it's the place where we have been frankly the slowest, getting some of our Path to Brilliance initiatives in place. As I talked about on previous calls, we were able to get some of our new organization structure and our new merchandising in place first on Zales and we're seeing some good green shoots behind having done that.

We've moved to the new org structure on both Kay and Jared beginning in January of this year and so we're beginning to see some I think improvements on accountability and decision-making on Kay, and we just haven't seen that quite yet on Jared, as we're continuing to get those right structural improvements in place.

Michele Santana
*Chief Financial Officer, Signet Jewelers Ltd.*

A

And I would just add, Ike, when you look at the promo shift we had mentioned there was a negative effect of 180 basis points because we shifted an event out of the first quarter to align closer to Mother's Day. So if you take that into consideration, Jared was basically flat in the fourth quarter.

Irwin Bernard Boruchow Jr.
*Analyst, Wells Fargo Securities LLC*

Q

Got it. And then just a quick follow-up, Michele thanks very much for all the details on credit. So it sounds like you're taking the credit headwind for the year up a little bit. And I think you cited higher fees on prime based on credit mix of deferred interest plans. Can you just help – I'm sorry; can you help me understand that a little better what exactly happened that kind of changed your view versus three months ago?

Michele Santana
*Chief Financial Officer, Signet Jewelers Ltd.*

A

Yeah, sure. So you're right. We've increased the outsourcing cost $145 billion to $155 million over our prior guidance of $118 million to $133 million. And really the primary difference as I said on the call is driven by higher fees on our prime portfolio related to a higher mix of customers that are electing deferred interest plans as compared to interest bearing plans. And then, of course, there's an incremental factor related to the higher bad debt expense that we saw in the first quarter, of which post Q1 we'll no longer be recognizing bad debt expense.

So as it relates to the mix that we saw, we're continuing to analyze the drivers, but what we wanted to do it just assume that this higher mix continues throughout the year in our guidance. We have put in place a very robust tracking system and working on optimizing the balance of our credit performance, making process and technology changes.

And then the other thing I would add, I guess, I mentioned on the call that when you think about the FY 2020 benefit that I gave, that does include a contractual step up in the revenue share profit percentage associated with the prime outsourcing.

Irwin Bernard Boruchow Jr.
*Analyst, Wells Fargo Securities LLC*

Q

Got it. Very helpful. Thank you.

Michele Santana
*Chief Financial Officer, Signet Jewelers Ltd.*

A

Thank you.

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

Simeon Avram Siegel
*Analyst, Nomura Instinet*

Q

Thanks. Hey, good morning, everyone. Gina, nice sequential improvement across most of the banners; Zales clearly stand out. Any thoughts on just the brand segmentation or the customer crossover between Zales and Kay at this point, has that changed your view or do you have an updated view on the size of your store fleet across those two concepts?

And then just Michele, I know a big – I think a big part of the Zales margin opportunity, if I recall correctly, originally was narrowing that productivity gap between Zales and Kay. How are we there now? And maybe any thoughts towards the Zales EBIT margin opportunity? Thank you.

Virginia C. Drosos
*Chief Executive Officer & Director, Signet Jewelers Ltd.*

A

So I'll talk to first two questions, Simeon, brand positioning and size of the store fleet. So as I mentioned in the call, we've been making good progress on completing our brand positioning, we're in agency reviews right now. We've done good fundamental consumer work to really understand who's been shopping in our different banners and how we can better positioned those to differentiate and create broader appeal across our portfolio.

And one of the things that we're seeing is the appeal that Zale has to a more Fashion oriented consumer. That kind of mindset crosses both Bridal and what we typically call fashion jewelry, so someone who is really looking for more of the latest trend are Vera Wang brand for example does quite well in Zales, as a result of targeting that customer. So I see continuing to be able to move Zales in that direction from a product and an experience standpoint, as well as the brand positioning.

I think on Kay, as the category market leader, we fundamentally really serve customers who are looking to commemorate a strong relationship or an important moment, gifting moments in particular. And so I see us being able to really talk to that on Kay and the love that's expressed through special jewelry gift. And so those will come to life as we roll out our brand positioning in the fall to be ready for a very strong holiday.

In terms of how we think about the store fleet in that context. We continue to take a very analytical approach to our store portfolio. You probably saw in the press release, we were down net 28 stores in the first quarter. We're very much on track for the roughly 200 stores closures we talked about. We're repositioning off mall and being very opportunistic in renegotiating our lease levels and just getting into the highest opportunity markets. And now that we're getting our brand positioning right, we can actually get our real-estate portfolio to better align up against those brands. So on Zales for example, that means qualifying a new off mall store footprint that would be especially appealing to our new target audience.

Michele Santana
*Chief Financial Officer, Signet Jewelers Ltd.*

A

Yeah. And I'll just add in terms of, Simeon, your question on Zale and the margin productivity metrics. Clearly, that is an opportunity. And even if you go back in the 10-K and look at what we filed and you look at the average sales per store between a Zale and a Kay, there still is a gap there. So that's been the focus and that is part of our Path to Brilliance with all the initiatives that Gina has spoken about including the real estate strategy that we do believe that we'll be able to increase the productivity of Zales as we drive that higher top line and as we continue to focus on the cost savings initiatives particularly in the gross margin side, that should be flowing down to the margin and we should be able to get expansion related to that. But as everything it's going to be gradual and incremental and it's not going to come overnight. But clearly the opportunity is there.

Simeon Avram Siegel
*Analyst, Nomura Instinet*

Q

Great. Thanks a lot guys. Best of luck for the year.

Michele Santana
*Chief Financial Officer, Signet Jewelers Ltd.*

A

Thank you.

**Operator**: Your next question comes from the line of Rick Patel with Needham & Company. Your line is open.

Rick B. Patel
*Analyst, Needham & Co. LLC*

Q

Thank you. Good morning, everyone. Curious to get your big picture thoughts on the use of promotions for the rest of the year, so excluding timing shifts, I believe you increased your promotional cadence in the second quarter of last year as you sought to be more competitive and go after market share. So as you begin to lap that, I'm curious if you're looking to increase promotions further year-over-year to remain competitive or if you're looking for it to be even and how that will play into the impact to gross margins?

Michele Santana
*Chief Financial Officer, Signet Jewelers Ltd.*

A

So let me start with that. And as you probably guess, for competitive reason, we're not going to get too specific in terms of what our promotional strategies and margin implications are for the year. On the call, we noted that in Q1 we had about a 20-basis point negative impact on our total gross margin due to shifts of promotions into the first quarter. And we had also mentioned on the call that in the past we have relied too heavily on the promotional spending lever, which at times can be confusing to customers. So part of the transformation plan that Gina has been speaking about, it's really looking at the promotions, the testing, learning new approaches how we market and target our customers. We're also doing a broad sale value service equation for our customers, to really understand the unique benefits that we can deliver to them. And that will really help us decide how best to provide that value equation.

Rick B. Patel
*Analyst, Needham & Co. LLC*

Q

And just a quick clarification on gross margins. Is it safe to assume that the factors that will result in higher gross margins in 2Q will presumably continue or even improve further as we go through the back half given expectations for sequential and comp improvement and that would mean that gross margins would probably be up in the back half of the year?

### Michele Santana
*Chief Financial Officer, Signet Jewelers Ltd.*

A

Yeah. So again, we don't provide necessarily gross margin guidance. I know on the call, we definitely wanted to give some color, just given the moving parts. The no longer recognizing bad debt expense will for sure continue to have a favorable impact. But keep in mind we'll start to comp some of that in the fourth quarter when we had sold the prime portfolio at the end of Q3.

So we'll continue to expect to see that benefit and then some positivity in the gross margin rate as we move forward. The other thing I would keep in mind is, the negative impact of it is, R2Net does have a lower gross margin rate. The discontinuation of credit insurance and a small impact for revenue recognition, but I also noted on the call, when you think about the credit insurance discontinuation in the R2Net we will start to comp those by the end of third quarter.

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### Rick B. Patel
*Analyst, Needham & Co. LLC*

Q

Thank you very much.

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### Michele Santana
*Chief Financial Officer, Signet Jewelers Ltd.*

A

Thank you.

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**Operator**: Your next question comes from the line of Oliver Chen with Cowen & Company. Your line is open.

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### Jonna Kim
*Analyst, Cowen & Co. LLC*

Q

Hi. This is Jonna Kim on for Oliver today. Thank you for taking our questions. We were just curious about potential opportunities to improve in-store experiences and what can be done more to resonate with younger generation of customers. And just another question is could you just provide a little more detail as to key priorities of the new Chief Supply Chain Officer? Thank you so much.

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### Virginia C. Drosos
*Chief Executive Officer & Director, Signet Jewelers Ltd.*

A

Sure. So in terms of in-store experience, I think there are a couple of things that are really on the horizon for us. One I talked about pretty extensively in the call is how we connect the offline and online shopping experience.

So for our customers we know that the jewelry buying journey, especially in Bridal is an OmniChannel journey. There can be seven to nine steps on the journey, about half of which are online and about half of which are in-store. So the more we can connect that seamless – that seamlessly for the customer the better that experience will be, and things like the ability to view online inventory, the ability to order and ship to store, so that you have a chance to see the product or maybe also see other comparable products, those are big improvements we think given the way the customer wants to be able to shop and what that typical journey is.

Another digital innovation, I talked a bit the program we have in Jared, but just to dimensionalize that further, we've bought beautiful retina screens that are now in about 70 Jared's and we have the capability to show customers over 100,000 diamonds that are in our inventory.

We take proprietary photos of those diamonds, more than 500 photos that we can show them in 360 degrees at 40 times magnification HD. Consumers have never seen a diamond in such a beautiful and transparent way and that's allowing us to augment the several hundred stores that might be in physical inventory, by also showing them a digital inventory that really presents a best-in-class experience for them.

Beyond that, we've been working on augmented reality. We had a couple of programs over the holidays that were very interesting, and we now have Ring Try-On, on our websites which is very interesting use of augmented reality and we're working through our R2Net team, which has really been at the forefront of digital innovation to also bring some virtual reality into our stores as a testing. So I think the in-store experience has a lot of opportunity to become very exciting for customers.

In terms of Steve Lovejoy, our Chief Supply Chain Officer, we're thrilled to have him onboard. He will be focused on driving Agility and Efficiency in our supply chain. I think that looks like speed of delivery to our stores, an ability to better leverage our store inventory for eCommerce capability whether that's shipping between stores more quickly to share inventory and he's also working very much on the cost savings aspect of Path to Brilliance that Michele and I both talked about.

Jonna Kim
*Analyst, Cowen & Co. LLC*

Q

Thank you so much.

Virginia C. Drosos
*Chief Executive Officer & Director, Signet Jewelers Ltd.*

A

Sure.

**Operator**: And your next question comes from the line of Paul Lejuez with Citi. Your line is open.

Paul Lejuez
*Analyst, Citigroup Global Markets, Inc.*

Q

Hi, guys. Can you talk about your Mother's Day performance this quarter and how much your comp guidance assumes a similar trend to what you're already seeing this quarter versus something better or worse than what you've seen? And I think you mentioned transfer rates as you think about closing stores you hope to see 30% transfer rates. Correct me if I'm wrong, but I am curious what you have seen thus far as you do close stores? Thanks.

Virginia C. Drosos
*Chief Executive Officer & Director, Signet Jewelers Ltd.*

A

Thanks, Paul. So we don't talk about results when we're in the quarter so about the trends, but I will say that our guidance for the second quarter includes the trends that we've been seeing so far. So that would be your first question. And then on transfer rates, 30% is about what we've seen on average over time. I'm hopeful that that's a conservative estimate because we've also been working on creating some new programs that can help to increase sales transference.

So for example, we've been giving more notice to our stores we'll be closing or repositioning a store which allows us to be able to help customers make the transition to another store location. Also make sure that we can make the customer experience seamless in that context. And then we have some marketing programs that we've put in place that can help us over time on transference rates. So these are all things that we're testing and learning about, but we're hoping that can help us improve on that 30% over time.

Paul Lejuez
*Analyst, Citigroup Global Markets, Inc.*
Q

And just a follow-up, does that 30% include eCom transfer as well? Or you're talking strictly stores?

Virginia C. Drosos
*Chief Executive Officer & Director, Signet Jewelers Ltd.*
A

No. It's – that's strictly the physical store transference rate and it doesn't include all the important efforts that we're also doing for eCom.

Paul Lejuez
*Analyst, Citigroup Global Markets, Inc.*
Q

Great. Thanks and good luck.

Virginia C. Drosos
*Chief Executive Officer & Director, Signet Jewelers Ltd.*
A

Thank you.

**Operator**: We have no further questions at this time. Thank you, ladies and gentlemen. This concludes today's call. You may disconnect.