Signet Jewelers Ltd

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William Hutchings: Good afternoon and welcome to the Signet -- Signet Jewelers session. I'm William Hutchings. I'm the analyst who covers Signet based in London, which is probably going to be an increasingly rarity for Signet going forward.

I'd like to welcome and thank Mike Barnes, Chief Exec -- Chief Exec, and Tim Jackson, the IR, and Ron Ristau, who's just around the corner who is also here. And thank you very much for coming to the Goldman Sachs Conference.

I think we're going to -- the format is going to be some opening remarks, and then we've got three standard questions, which I'm sure you're getting very familiar with at this stage of this conference. And then we're just going to open it up, so please do feel free to ask questions. So over to you, Mike.

Mike Barnes: Okay. Thank you very much, and thank you all for coming. We appreciate it very much. It's good to see you here.

I'll just make some short opening remarks because I want to make this a very interactive process. I think it's more valuable to all of us that way.

But we were pleased to announce a couple of weeks ago record earnings for the second quarter in our fiscal 2012. We had a fantastic quarter. We had great strong comp sales.

What really drove our business model was all of the competitive advantages that we have as the leader in the industry. And that really starts with the people. We have what we consider to be absolute best in class customer experience. We train our associates, our managers, and our regionals very thoroughly. And we develop them in many different ways. And we consider that to be our absolutely most valuable asset, are the people that we have in the stores day-to-day giving the best customer experience in the industry.

Other things that we do. We have fantastic product ranges, and we do this in many different ways. We have a lot of exclusive differentiated product ranges that have really helped drive our business. They've become a bigger and larger part of our business over the years, and it's something that sets us apart and really does differentiate us from all of the other competitors in the field.

We also have a great national advertising support because of the scale, because we are the largest jeweler in the United States. We have the ability to go out and support all of these

fantastic product ranges and our stores with national product advertising.

We have several different focuses. We focus on both the fashion category within our stores. We have exclusive and differentiated products there. But we also focus very, very much on the bridal category, which is a very important category to us. And we've developed some very exciting product in that area, even within the past few years.

Finally I would just say I think that our business model absolutely works, and that's why we have become the best in class in this industry. If you look at our market share statistics of the specialty jewelry industry in the United States, we've almost doubled our percentage of market share over the last ten years and clearly become the number one leader in that market share race.

This has been done through strong operating performance and our financial flexibility that we've maintained with a strong balance sheet. And with that I would like to throw it out for the questions.

William Hutchings: Okay. There you go. So the first question is what is your -- what is your base assumption for the macro outlook? Are you static, is it getting worse, is it getting better? Where you stand at the moment?

Mike Barnes: Which day are you asking me on? It's been an absolute -- it's been a volatile market place, and that has really kicked up its heels I guess in the last five weeks or so. Everybody was hopefully recovering nicely, if albeit slowly, from the recessionary period that we all faced a few years ago when it was at its worst, and we had more volatile activity, especially in the markets out there within the last five weeks that we've seen in two years quite frankly.

So how do we prepare for that? Number one, we continue driving our competitive advantages. We continue going after profitable market share. We continue developing the best product in the industry. And we continue training the best sales associates and managers in the business. And we don't know what the macro economic outlook is going to be so we have to continue to prepare to drive our business model.

The outlook is something that we all have to deal with, we all have to face it. It's the same for everyone when it hits. And the important thing is not what is it going to be, but how are we going to deal with it? And we would deal with it the same way we did last time in a very effective manner.

There's a lot of levers that we can move if the economy does turn down, and we were able to do so very effectively during the last downturn. We can appropriately right-size inventories to current sales trends if they change. We have an inventory basis that is not as fashionably fickle as a lot of other industries in the retail sector. The inventory items that we have don't go out of season.

If you're caught with a storeroom full of shorts and you're going into back to school season, you've got to do extremely deep markdowns and take big margin hits. And that's not something that we have to deal with.

So we're able to cut back on capital spending if we need to. We're always going to be spending money to keep our stores up to date because we need to look like the leader that we are in the industry. But of course in bad times you can always adjust that.

The reality is during the last downturn over a two-year period I believe, Ron, we raised

about $700 million in cash flow.

Ron Ristau: (Inaudible - microphone inaccessible.)

Mike Barnes: And that was done through very strict financial management, and it worked. It set us up to have the power that we have today. And coming out of that recession, it gave us the ability to go after even more profitable market share, and I would say we would handle things pretty much in the same way.

William Hutchings: Thank you. The second one, which I think is going to be particularly interesting for you given we've all seen the gold price jump, the silver price jump, diamonds, et cetera. So pricing for you. What are you planning? What do you -- what kind of magnitude does that price drop -- I guess more interestingly, how do you measure or know the -- how receptive your consumers are to those price rises?

Mike Barnes: Well, it's something that we focus on every single day. You're right. I check the gold price first thing in the morning when I wake up everyday to see where it's going. But it's a fact of life, and it's actually something in this industry that we've had to deal with for many years because the commodity prices have pretty much always gone up.

Gold has not just started going up. It's been going up for many years. It's accelerated quite a bit. This year I saw it go through the $1400 into $1500 and $1600 and $1700 and $1800 range. I mean, it's amazing. You have gold at almost $2000 an ounce not that long ago, and it's also volatile. It tends to go up and down pretty broadly over any given day and sometimes over any given few-hour time period.

So how do we deal with it? Well, we have -- we have publically stated that our intention is to at least maintain our gross merchandise margins, and we have been able to do that. And in fact we have grown them slightly, even with the climbing prices out there as a headwind against us.

It's something that we are able to do. We have been able to raise prices. Something, as I said, that we've dealt with in this industry for a long time, and I believe that we do have the added benefit that people expect prices of valuable commodities, precious metals, and gemstones to increase in value over time. So it's something that's a little bit more acceptable to them. And it's also got an underlying value associated with it.

If you own something made of gold and the price goes up, your item of jewelry just increase in value as well to a great extent. And the same thing goes for diamonds. So I believe it's something that we can maintain. We can continue to hopefully keep up with any further price increases that we see on the cost side of things.

And then finally what I would say is if you really study how our business model works, we sell products along a continuum. So for any particular design esthetic, we have a very broad range of prices available to the consumer.

In fact, and I know that you're not going to be able to really see this out there, but this is one of our exclusive brands. It's called Love's Embrace. And the design esthetic is about the same on all of these because it has a very specific design associated with the brand Love's Embrace. But because you can have different base metals, different numbers of diamonds, different sizes of diamonds, we actually have a range with one design look that you can buy from $89 -- $89.99 to $2000.

So along that continuum, we have something for every consumer out there. And in this

business, quite often when a consumer walks into a jewelry store they have a price point in mind. Maybe it's my wife's anniversary and I decide I'm going to buy a $400 pendant for her for this anniversary. There's plenty to choose from, and that could range anywhere from $100 to $2000, as I said. So that gives the consumer much more choice.

And you also don't feel the difference in the pricing because of the broad price range that we have and indeed because you don't shop for jewelry every single day of the week. It's not like filling up your car with gasoline from one week to the next and you see the price of one tank of gas change by $10 or more. So that's kind of the way that we deal with it.

William Hutchings: Great. Thank you. And the third question is on capital allocation. Again, pretty relevant for you guys in terms of how do you think about splitting it between organic growth opportunities, buybacks, managing -- managing the balance sheet, and then the potential for M&A.

Mike Barnes: Okay. Thank you. Yes, capital allocation is definitely a subject that we spend a lot of time studying and thinking about. When I came onboard here at Signet, one of my first goals was, and Ron as well, to very thoughtfully and thoroughly study the situation and study our long-term business plans and objectives.

Clearly the first place that we want to reinvest our money is back into our business. That's where we feel like we can give the best return to all of our shareholders. We want to continue growing and being the leader in the market place, and that's something that is extremely important to us.

We are growing and investing organically where and when we can. We have continued to open stores, albeit at a slower pace than in the heyday of five or six years ago. A lot of that has to do -- most of that has to do with the fact that there's just not as much real estate development going on right now.

And so finding the quality real estate with the demanding returns that we expect to get out of it is not -- is not as easy as it was when there was a lot more development and building going on. So we're investing organically into our own stores.

We're also investing in a lot of remodels of our stores. As the market leader, we need to look like the market leader, and it's very important to keep our stores in the best shape of anyone out there and make sure that we look like far and away the market leader in the industry.

We are also looking at and open to look at strategic opportunities, organic or otherwise, if they become available. And as we study our long-term strategy, over the next five years or so that's something that we need to remain open to and looking in to because the world is changing. The world is becoming more of a global market place, and there are a lot of different ways and areas that growth may come in the future.

We need to continue evolving our industry towards that direction and make sure that we are open minded to new and future ideas out there.

Finally I would say that -- two other points. One is, it's more appropriate to keep a certain amount of cash on the balance sheet more so than in 2008. It seems to be the prudent thing to do in this volatile economy and not knowing exactly where things are going. And we feel like it's in the best interest of our shareholders to do that.

But at the same time, we don't want to build an inappropriate amount of cash on the

balance sheet. We did announce when we announced our earnings a few weeks ago that we have initiated a $0.10 per quarter dividend. This is very important especially in these volatile times because hopefully it shows that we have great confidence in our ability to continue running our business model in a very profitable way with strong cash flows, and we felt like that was a great start.

We're going to take it step by step, and we're going to be prudent about how we do it and thoughtful about how we do it in terms of making decisions about capital allocation and our balance sheet and the cash. And that's a really good start for us. It's not the end all, be all for us in terms of what we think we'll need to do in the future.

And as I said, we don't want to build what we would consider to be an inappropriate amount of cash on the balance sheet. So we will continue discussing and addressing that issue on a go-forward basis.

William Hutchings: Thank you very much. Now I believe that we have -- might have a mic for questions. So just start off at the back.

Unidentified Participant: Yes. I was wondering if you could comment on the austerity measures in the UK and its implication for Ernest Jones and H. Samuel, and also if you were particularly affected by the riots earlier and if you'd need to take a -- reserve that?

Mike Barnes: Thank you very much for the question. I'll start off and Tim and Ron, you guys feel free to jump in here on this one, especially our expert, Tim, who comes -- hails from London.

The -- there's a lot of things, austerity measures being one of them and the fear of it probably more so than even the reality of it. But the economic situation in the UK is very, very difficult right now. Retail is having some of the toughest times that it has seen in probably over I don't know, a hundred years or something, Tim? It's been a long time.

Tim Jackson: Absolutely.

Mike Barnes: It's really a difficult situation right now. The taxes have hit hard in a time when the disposable income is not really rising. You have high inflation. You have the second VAT tax increase in two years, 2.5% per year for a total of 5%. You have the austerity measures. And you have -- the riots on the streets certainly didn't help.

The bottom line is we're outperforming the retail market place in the UK and very proud of the way that our team is handling things in this environment. If you look at the broader retail numbers out there, we have consistently outperformed by 6% to 7% for much of this year, and we continue to do so.

The last two quarters we actually had, albeit very small, positive comps in the UK market place. And that was a turnaround for us as well.

So based upon the very tough environment, how we're performing right now, the way that we continue to invest in our businesses in both merchandise and into our stores in the UK, we feel like we are setting ourself up to really come out of this tough economy when it does improve and continue to take market share where we are certainly the largest jewelry operator already within the country.

Unidentified Participant: Yes, Mike. I would like to follow up on the consumer price elasticity issue. As you attempted to pass along or mostly passed along the cost increases, are you seeing any kind of unit volume reductions or is it a trade down effect or are people buying to a

certain price point and then maybe accepting lesser goods? What kind of consumer behavioral impacts are you seeing?

Mike Barnes: It gets a little bit confusing, thank you for the question, to -- when we talk about units because normally we talk about units and we usually separate out our bead program because it's such a unit-driven business.

So if you look at all of our products, we're not seeing any downsizing in terms of the number of units that are being sold because the bead business has been very strong and has driven a lot of unit sales for us. If you exclude the bead business, then units have contracted somewhat.

We are seeing the consumer -- they do move up and down that continuum of pricing. One year they may have a budget of $400 for something, and the next year it may only be $200. At the same time they realize that what they might have gotten for $400 last year, for the same $400 they're getting something a little bit less.

But the beauty of the business model is that we do have such an offering that there is something for everyone out there that's looking. And it's an ever-changing environment. So as unit sales came down in certain categories, we saw them go up in others such as the beads, as I mentioned, and they somewhat offset each other. And it has -- it's worked out for us very well.

We take a very scientific approach to our price increases. Our merchants do a fantastic job because they've been doing this for many years of figuring out exactly how, when, and how much to change the prices on the merchandise.

We also have the added benefit that because we're in an industry with a relatively low turn, we can see the cost increases coming at us because we're on an average-cost basis. So we have time to react. We have time to plan it out very effectively and efficiently. And so far it has worked for us well. The consumer has not reacted adversely.

We have made sure that on a net basis the cost increases don't cost us so much in units that it decreases our overall business.

Unidentified Participant: It sounds like you're able to pass through most of the cost increases that you're seeing?

Mike Barnes: I would say that we have been able to pass through all of them pretty much because we have maintained our gross merchandise margins on the whole on a consolidated basis.

Unidentified Participant: Most people when they're in bridal I assume they have a price point in mind, whether they're going to spend $5000 or $2500, whatever the price point is. So you're able to match that and meet that price point and make your margin there. But have you seen a trade down in the sense? Has the average price point in the bridal area gone down? Has there been -- has the economy had an effect on that?

Mike Barnes: You know, very interesting question because -- not really. I'm sure it has for a lot of people because I'm sure that they've been constrained on how much they could afford to spend. But again, we have such a broad selection and many different brands, and we can cover the needs not only in price but also in what the consumer's looking for in terms of features on the bridal side of things. And I'll give you an example in a moment.

But in many cases, we have actually seen the consumer trading up in price point. For instance, one of the new lines that we have launched recently is called Neil Lane Bridal.

Neil Lane is a jeweler. He is based in Los Angeles. He is kind of known in some ways as one of the jewelers to the stars. And he does a lot of different things. He outfits a lot of the stars for the runway shows for like the Oscars.

At the past Oscars he had jewelry on Reese Witherspoon, Halle Berry, and several other famous actresses out there. And he's building a great brand name with his bridal jewelry. It's beautifully designed, and it's very exquisite.

I think what the consumer, in the US particularly, is looking for is great style, fashion, newness, and differentiation, and they'll pay more for it. One of the top SKUs in that Neil Lane Bridal category for us happens to be one of the highest-priced items, and that is a $7000 ring that is sold at Kay Jewelry Stores in the malls. Keep in mind that at Kay the average price point for this purchase there is $350, and this is $7000.

So I would say, especially in the US, the consumer's voting more for fashion and newness and design than they are for the price point. But we do have it available all along that range for them.

They're also looking at what features they want in their product, and I'll give you an example of three different consumers walking in to one of our stores.

If someone walks in and they say I'm just looking for the most beautiful, the brightest, the shiniest, the sparkliest diamond, that's what I want. We can lead them over the Leo, which happens to be our oldest differentiated brand and our largest one still, and it's been extremely successful for us. We launched it eleven years ago. Well it is certified to be visibly brighter because of the way the diamond is cut. And that's very important, and it's a feature that a lot of people want.

Someone else walks into the store. Maybe they have more of a perfectionist slant to them and they say I want the perfectly-cut diamond. I want something that is just the ultimate diamond. Then maybe I would walk them over to our Tolkowsky exclusive proprietary range of diamonds because it is the ideal-cut diamond. And that is a -- that is a cut called Ideal. It was actually invented by the Tolkowsky family, which also makes it a great brand name for us to sell.

And then if a third consumer walks in and says look, to your original point, I have $2000 to spend. That's all I've got. What's the biggest diamond I can get for my fiancée for that? And maybe I'll take them over to our still great generic range of diamonds and get them the most bang for the buck there.

So this whole differentiation, even within our own stores with the multiple brands, has been a very positive evolvement of this business industry, and it's really changing the industry. It's not the same industry as it was 30 or 40 years ago where it was basically, other than maybe some branded watches, a very generically-based industry.

Unidentified Participant: I am very sorry to interrupt, but security is asking me to make this announcement. Does the black suitcase by the wall right here belong to anybody in this room?

Mike Barnes: What was your question?

Unidentified Participant: (Inaudible - microphone inaccessible.)

Mike Barnes: Questions?

Unidentified Participant: Can you talk about a little bit the test and react strategy and kind of how long that's been going on, whether you're going to get better, and give us a little more color on kind of what goes on there exactly? Thanks.

Mike Barnes: Absolutely. Yes, test before we invest is what we really call that, and it is something that I was very happy to see when I got to the Signet group because it's a philosophy that I have embodied for more than 25 years. I've always believed in test, react, test, react, and then rollout.

Clearly when you launch a new brand, a new category, a new item, whatever it might be, you never get it right all the time. You never get the perfect mix. So it just makes sense to go into a select number of doors, test the new range that you want to launch, react to what the consumers' feedback is on that, deal with that and change up the range to fit their needs better, and then once you have it right -- you just keep testing. Once you have it right, start rolling it out to the doors.

We think it's the most prudent way to operate a business model. It is -- it really embodies the pull strategy as opposed to a push strategy of your merchandising, and that is we want to sell our customers what they want to buy. We don't want to try to force what we want to sell onto our customers. And by testing and reacting and listening and paying attention and then changing to meet their needs, it creates the best most effective efficient business model, and it works for us.

It has worked for us for many years, and I think it will for many, many more years to come.

Unidentified Participant: Can you give us a bit of an update on the inventory situation in the retail channel, both your own and more broadly the competitive landscape and where you think inventories are both in the US and the UK?

Mike Barnes: Ron, you want to take that one? The inventory?

Ron Ristau: What did she ask?

Mike Barnes: The inventory landscape, both our own within the US and UK and what we think it is in the industry in large.

Ron Ristau: Well our industry -- our inventories are in very good shape relative to -- if you take a look at the growth and sales that we experienced, our inventories are up about half as much as our growth rate in sales.

And what's going on in managing our inventories both in the US and the UK is that we're dealing with commodity inflation, as you all understand. So what's happening in order for us to keep the inventories in line, we're actually having to be very, very measured in what we invest in, and the things that have slowed down in turn in any way have to be called backed and the units cut out of the inventory. Otherwise you'd be seeing a very substantial increase in the price of inventory just on the basis of commodity trends.

So our inventory groups are consistently improving our unit turns. Our unit turns continue to go up year in and year out. Even this year we have experienced -- last year we thought we can never improve the unit turn any higher than what we did, and it's up another 10% or so.

So we keep at this process. It's a very active process within our Company.

For the broader industry, I can't really speak to it. I would just simply say that I would think that if you were not using an average inventory method and you're -- like small independents are feeling that price pressure and passing through prices faster or seeing their margins deteriorate because they're going to deal with the effect of a commodity much more rapidly than we will according to the way that we do it. So I hope that answers your question.

Unidentified Participant: Related to that question, what percentage do you think the -- you said commodity inflations have been going on, so what percentage this year -- you're using cost right now. What percentage higher than cost do you think it is in terms of market value (inaudible) cost? (Inaudible).

Ron Ristau: Well, yes, I think -- if you were to break out our inventory increase, like the increase in the value of our inventory on our balance sheet. Of the increased percent, it's probably 60% of it is commodity related, and the rest is additional inventory that we've had to put in for supporting some of our launches, and that is then offset by some of the cutbacks that we've had.

Unidentified Participant: What was the (inaudible) replacement cost of (inaudible)?

Ron Ristau: The replacement cost of our inventory? If you went up to buy all of our inventory on one day, which would never happen in the history of time --.

Unidentified Participant: No, I know, but I'm trying to understand it from a point of view of your -- your cost of (inaudible) would be much lower than what they will be in the future.

Ron Ristau: No, our average cost will continue to rise over time. There's no question about that. Okay? People ask that question all the time. It's a huge number if you had to go out and price the inventory in one particular day, hundreds of millions of dollars more than what would be on the balance sheet today.

Unidentified Participant: Right. What I'm trying to get at --.

Ron Ristau: So what would happen over time, our inventory costs will continue to increase as long as the commodity costs continue to increase. What we will do to offset that is increase our prices, like we've done for the last 15 years.

So commodity cost inflation is something that we have very well established and learned how to manage. Because of the slow turn and because of the way that the average inventory cost increases, we can see it coming, our planning departments and merchants can see it coming, and then we set our prices. When we do, which is usually around the first quarter or beginning of the second quarter of the year, and we manage it so that for the year we're at least maintaining our gross merchandise margins. That's how we do it.

And it's a function of understanding what the turn is, what you think the commodity inflation rate is, and then pricing yourself accordingly. And then the art of it is mixing it all, as Mike has indicated, across a broad -- a wide range of prices so that when the consumer comes in it's not sticker shock because everything has gone up.

What they're going to do is there's always an opening price point, which is very attractive and a great value for consumers. We work very hard to keep those opening price points ranging up to $2000, $3000, $4000, $5000 depending upon what a consumer wants to spend.

Unidentified Participant: So what you're saying is at the profit margin of $1300, what you're saying is that you're selling it off of the $1300 price increasing it by the gross margin on that cost of $1300, instead of the fact that it's an $1800 today. So you're selling gold to people -- I'll simplify here, but you're selling gold at old prices to people?

Ron Ristau: We're selling gold at our average price.

Unidentified Participant: Right, but your average price is a good deal for the customer, but I mean from a business decision, shouldn't -- the prices of the gold are sitting at $1800.

Ron Ristau: That's a great deal --.

Mike Barnes: You have to take it step by step. And as our average price increases, right, because the latest purchases have been in the $1800 range, not the $1300 range, although we still have inventory that we bought at $1300, which is what you're saying.

Unidentified Participant: Yes.

Mike Barnes: But because it's averaged out, it's a very slow change from quarter to quarter in terms of how the prices change, and because we track it so effectively and we see it coming so far in advance, we change our prices.

The important part of that is if we have a commitment, which we have made and have kept to maintain -- at least maintain our gross merchandise margins, then it almost becomes a moot point as long as we're able to do that. And that is what we do.

So we don't want to raise the price too much to current spot price because then we're going to be overpriced relative to where those products should be. The margins would look great, but I think that our units would get hit quite considerably there. Whereas if we do it slowly over time as our average cost creeps up based on higher commodity prices, then effectively we're in the economic spot where we need to be price wise for the consumer.

And it also changes their prices slowly over time as opposed to one big jump.

Unidentified Participant: Thank you.

Unidentified Participant: Two questions please. Mike, you have a unique background coming from Fossil. Obviously you've gotten your arms around this business, which is a good business. But are there any things from your kind of Fossil model that you might be able to implement here over time? Anything that you see that might be obvious to improve the business further?

Mike Barnes: Yes. Thank you. Yes, I think one of the most exciting things about coming here is I see the evolution in this business and I see it moving in a direction that I'm very familiar with. I talked about it a lot already so I won't go into too much detail, but this is turning into more of a branded business.

It's becoming less generic, more branded, which drives excitement. You can build equity within those brands, and you can build long-term customer loyalty and trust with brands. And branding is something that I have done for well over 25 years, something I'm very familiar with, and I believe that that's a major direction for this industry, and I'm glad to join it and become a part of it at a time when that's happening.

Unidentified Participant: And then the second question is a lot of investors obviously think you have a great business model and kind of a low valuation. What would -- over what time frame might your board get comfortable with buying back stock and kind of what would they have to see to get more comfortable with doing so?

Mike Barnes: That's something that we do talk about at the board level all the time, and we are studying that. With myself being now nine months into my tenure here, what I've discussed with them is that we need to look at our capital structure, but we need to do it holistically in terms of what is our overall long-term strategy.

So now going into really my first annual budgeting phase that we have begun and looking to tweak the long-term strategy based on what we know today and where we want to take this Company, I think that all of these things will come together. And whether it's through a stock buyback or some other means, we will get comfortable addressing the capital structure even further than we already have with the dividend announcement that we made.

William Hutchings: I'm afraid we're out of time. It's quite a strict time. We've got a big clock up in the back there. So I'm going to have to wrap it up there. But Ron, Mike, Tim, thank you very much. That was great.

Ron Ristau: Thanks.

Mike Barnes: Thank you all. We really appreciate it.