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Conference Call Transcript

SIG - Signet Jewelers Ltd at Piper Jaffray Consumer Conference

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CORPORATE PARTICIPANTS

Michael Barnes
Signet Jewelers Limited - CEO

Ronald Ristau
Signet Jewelers Limited - CFO

CONFERENCE CALL PARTICIPANTS

Neely Tamminga
Piper Jaffray - Analyst,

PRESENTATION

Neely Tamminga - ***Piper Jaffray - Analyst,***

All right. We'll get in right before lunch. My name is Neely Tamminga, the Senior Research Analyst and the Managing Director here at Piper Jaffray in the consumer sector, it is a privilege to have Signet with us today, that is not a name that we cover, yet. However, we've got CEO, Mike Barnes and CFO, Ron Ristau. And Ron and I go way back to the New York & company days and Mike and I go back to the Fossil days, so this is a little bit of a reunion or home coming.

So why don't we just kick it off and you guys talk about your business, maybe frame up for these investors kind of your two or three top opportunities or areas of growth that are really going to drive your business over the next call it 12, 24 months.

Michael Barnes - ***Signet Jewelers Limited - CEO***

Great. Thanks Neely, I appreciate it. And it's good to be here and see all of you as well, thanks for coming. We have so many great initiatives right now in both our bridal category, with both branded and non-branded initiatives within that category and then also in our fashion branded business. One of the things that really excited me about coming to this company is the opportunity that exists in so many areas including brands. We're really in an early innings of the branded story, I think and the jewelry store industry.

Because historically it's been known somewhat of more of a generic business I would like to say this is not your grandmother's jewelry store anymore. You go in and it's no longer about diamonds are here and gold is here and earrings are in this section, 'what are you looking for?' It's a lot more exciting it's more branded. And as I said in both the bridal and the non-bridal category and to me that is really compelling for the consumer and I think it is really driving our business. If you look at especially our exclusive or differentiated brand ranges that we have, last year they accounted for about 22% of our business and that was up 300 basis point from the prior year.

And as I said, we are still in the early innings most of these brands have only been around for a few years, many of them are still in test. And so as we see them succeed, we are continuing to roll them out. Some of the ones that I would talk about on the bridal side would be some of the diamond brands that we have, the oldest exclusive brand that we had is the Leo Diamond, which is known to be visibly brighter.

The great thing is though as we've added other brands, we are not really cannibalizing any of our business because of the way that we are positioning that portfolio. We have the Leo Diamond, we have Tolkowsky diamond, we have Peerless diamond, we have Neil Lane in bridal which is just fabulous Neil Lane is known as like a rock star in his own right. He is kind of known as the jeweler to the stars. Neil Lane did a lot of people for the Oscars, Reese Witherspoon was one of them this year, Halle Berry was one of them, Jennifer Hudson, et cetera. And he also produces the bridal set for the Bachelor television program and I'm sure most people know what that is.

So it's a really exciting brand and the way that we've positioned them is to match the needs of all of our customers that come into our environment. If someone walks in and she is looking for I just want the diamond with the most sparkle to it, we can guide them to Leo which is known to be visibly brighter. The guy comes in and is more of an engineer type and he says, drives me crazy if something is not just perfect, we take them to the ideal cut diamond that Tolkowsky or Peerless diamond. So we have something to offer everyone and then on the other side when

we look at our fashion offerings, they are extremely compelling as well. And again we have a lot of exclusives or differentiated brands, Jane Seymour Open Hearts is a great brand that we've had now for three to four years and continue.

Neely Tamminga - *Piper Jaffray - Analyst,*

And that's exclusive to you.

Michael Barnes - *Signet Jewelers Limited - CEO*

That is exclusive to us, completely exclusive, which gives us the competitive advantage over everybody else's offer in the industry having these brands because nobody else can get them. It also creates an environment where there is less discounting, because you can't compete directly against the brand, you can try to come up with other products that are similar, but you're not going to have the branded feel or the branded communication that we have. And we are able to communicate all of these brands very effectively because we have a very large advertising marketing budget and that's something that we have the scale to do.

And again it's a competitive advantage because no one else really has the power or the scale, to spend on national television advertising what we do. And we know that, that is building our concept brand awareness with all the consumers out there. Because everybody knows 'every kiss begins with Kay' and 'he went to Jared'. Now those are two tag lines that I hear all the time in fact when I joined the Company, some of my friends sent me an email they are not even in the industry and they said, oh, you went to Jared.

And so it's something that resonates with the consumer, they hear it, they understand it and they trust it and that's very important for today's consumer as well, to be able to have that trust and build that trust with them for an ongoing relationship.

Neely Tamminga - *Piper Jaffray - Analyst,*

Let me pause there for the audience, explain that the divisions that you have in different brand, Jared, you've got Kay.

Michael Barnes - *Signet Jewelers Limited - CEO*

It's Kay and Jared for the most part here, we also have some regional brands, still, that are kind of left over from acquisitions that we made many years ago and we have transferred as many of those into the Kay concept as we could to get the benefit of all the advertising that we do under that umbrella. And then in the United Kingdom we also have the H.Samuel, which is a middle market and we have Ernest Jones which is an upper middle market store. So it's very similar to what we have in United States, we are the largest retail jeweler in the United Kingdom and in the United States, and it gives us a lot of competitive advantages all the way through the supply chain, also with our marketing and advertising opportunities and even in working with brands because, we are the ones that most brands are going to come to if somebody has a great idea to put their brand into the jewelry sector they are going to come to Signet Group first.

Neely Tamminga - *Piper Jaffray - Analyst,*

So what do you see as their key drivers and as this is growing more doors is it leveraging your customer base we absolutely will be framing up and thinking about your growth.

Michael Barnes - *Signet Jewelers Limited - CEO*

Well, driving productivity through our existing board is big for us obviously that is helping us drive, our com store sales and a lot of profitability right now. We still don't have as many opportunities as we've seen in the past on the real estate side. There is less development happening, in the real estate show was a couple of weeks ago in Vegas and feedback that I've got from it was that a lot of the developers were going to work and reinvesting in existing projects that they already have been upgrading those.

So that seems to be a little bit of a trend right now, we are doing the same thing. We are taking our stores and we are re-fitting them, we are updating them both here and in the UK, we are making investment in both sides of the pond, really setting ourselves up to continue to take

profitable market share. And to be very successful, especially as the economy hopefully continues to improve over here and hopefully will start improving in the UK a little bit.

Neely Tamminga - *Piper Jaffray - Analyst,*

Now Ron, that's a good segue over to you and put the capital allocation of the Company, as a king holder of the capital of those companies. How do you think about redeploying your capital on the CapEx side, is it going to be for the store refresh or how do you think about that?

Ronald Ristau - *Signet Jewelers Limited - CFO*

Well, during the recession, we like many companies, cut back our capital spending to the levels that were substantially below depreciation for several years. So this year, we've gone back and we settled to spend about between $110 million and $130 million in capital, which is the more normalized rate of capital spending.

About $15 million of that would be spent on about 25 new stores, $60 million on refurbishing in both in the US and the UK and the residual $40 million on the new multi-year initiatives in our IT infrastructure to continue to develop not only our existing operating systems but build a lot of additional capabilities into our internet websites, which is a major initiative that might really push forward at a much greater accelerated rate since he's joined the Company and we think it's a very important opportunity for us.

But that side of capital allocation over the next three years would be what we are looking to do and hopefully ramp it up even a little more with new store opportunities as they present themselves.

Neely Tamminga - *Piper Jaffray - Analyst,*

And because I don't know, I mean, where do you, how do you dash board your success from this capital allocation you guys will return some investment capital focus company, certainly you have some roots of that I think coming out of the Fossil world I'm just curious how.

Ronald Ristau - *Signet Jewelers Limited - CFO*

That's a very discipline processing and we look for a five years return on investment capital about 20% would better to retain.

Neely Tamminga - *Piper Jaffray - Analyst,*

Okay.

Ronald Ristau - *Signet Jewelers Limited - CFO*

And we do that in a very conservative basis 'cause we own our own manage our own credit portfolio, so when we think about investing in a store particularly in the US We include in that, the cost of building that receivables file. So it's a very it's a fully absorbed model considering all aspects to the business and we take 20% and that 20% all in that including inventory and receivable build.

Neely Tamminga - *Piper Jaffray - Analyst,*

Here questions about the credit portfolio abated a little bit was from the post recession, I feel like that the only thing they are asking about, for a period of time.

Ronald Ristau - *Signet Jewelers Limited - CFO*

The credit portfolio has done exceedingly well, particularly over the last two years it's recovered rapidly toward the historical norms. We reached the high at bad debt losses in the US that is about 5.6% of sales about two years ago. And since then it's been improving, last year we improved

that rate to 4.2% of sales and in the first quarter of this year our bad debt percentage was approximately 1.6% of sales, which was lower than the historical average for the first quarter.

So we've always said about that, that it would return rapidly to the historical level which was ranged between 2.8% and 3.5% of sales historically, very consistent over a 10 year basis. And that really seems to be the direction that we are heading very rapidly. It helped our gross margins in the first quarter it helped our gross margins through all of last year and we continue to see that trend get better.

Michael Barnes - ***Signet Jewelers Limited - CEO***

To your point Neely, we were unfortunately battle tested and proving that has the good management grasp on that credit portfolio. I would say that based on the fact that the facts and the numbers that we see, we at least managed it as well as anybody else out there granting credit to the consumer industry. The other thing that is important about this credit portfolio is we are not in the business to make interest of the loans. We are really using the credit portfolio to facilitate driving more and more jewelry sales, we have proven that the customer that buys through our credit is worth about two and a half times a customer that does not buy through our credit.

And the way that we also manage that portfolio is, when people come in and they buy on credit, we encourage them to pay that off as quickly as possible, not make minimum payments and take 47 years like a credit card. Because we want them to pay it off and on average they pay it off in less than a year and that opens up their personal open to buy to buy more jewelry and that's really what drives that and it's been a very strong part of our business and again is a competitive advantage because no one else in the industry runs their own credit portfolio.

Neely Tamminga - ***Piper Jaffray - Analyst,***

Can you just clear us a little bit to your onboarding Mike and you've been in this role of CEO less than 8 months at this point, seven months?

Michael Barnes - ***Signet Jewelers Limited - CEO***

It's been I'm going on seven months total, I just finished my first quarter that's all.

Neely Tamminga - ***Piper Jaffray - Analyst,***

So you finished your first quarter, you're learning everyone's name?

Michael Barnes - ***Signet Jewelers Limited - CEO***

Yes.

Neely Tamminga - ***Piper Jaffray - Analyst,***

Maybe talk a little bit about what attracting you to the opportunity, certainly it was a long time CEO search, that's what we've seen with some other brands and what you see as an opportunity?

Michael Barnes - ***Signet Jewelers Limited - CEO***

Sure, I'd be glad to, well, as you know from my background I was with Fossil for over 25 years, really helped with that company started and watched it and helped it grow from zero to $2 billion in revenue and very successful company, very well run company, there is great management that are still doing a fantastic job. Honestly I never really thought about leaving, after 25 years. But as I started talking to the board of directors here at Signet and really finding out more and more about the Company and the direction that it has been moving and where it needed to go in the future, I felt like, wow, there is a great opportunity here and I think it's going to be right in my wheelhouse.

Because I came from a highly branded background and as I mentioned, I think a lot of our brands are going to help drive us in the future it's not all going to be branded but a lot will be. And I just think there is a lot of potential opportunities out there to be explored and that's what excited me I knew the Company quite well in the UK anyway, I've been doing business with them for over 15 years.

Neely Tamminga - ***Piper Jaffray - Analyst,***

I guess Fossil was selling into right.

Michael Barnes - ***Signet Jewelers Limited - CEO***

Because we were selling many fashion market into Signet Group in UK. So it wasn't a company I was unfamiliar with and I had met the prior CEO, here at Signet on several different occasions in the watch business. So it just looked like a fantastic opportunity, just right for me at the time and that's what drove me over here and I will tell you, I'm very, very happy to be here. I've found the culture of this company to be very similar to the culture that I came from and it's a great group of people both herein and the UK. And they have a common spirit and there is tremendous amount of collaboration amongst them and I am very excited to be here and be part of the group.

Neely Tamminga - ***Piper Jaffray - Analyst,***

Talk a little bit, over to Ron over the line cost, cost, cost, cost everybody is really concerned about cost and cost inflations. And we are taking the opportunity to ask each one of our companies at the consumer conference, what their view, what their take is on that overall inflationary cost environment. So for you what are the primary pressure points maybe in the cost of sales and then at this company and then what are your expectations?

Ronald Ristau - ***Signet Jewelers Limited - CFO***

Well, the primary pressure points are very straight forward, they're gold and diamonds which is what drives the majority of our business sales. And we have been dealing with an inflationary environment in the jewelry business for many, many years. So commodity inflation, while sometimes like right now it's at a greater pace than in the past, dealing with it, maintaining our margins in the face of commodity inflation, the consumer's willingness to accept higher prices that they understand with the underlying value of what they are buying is increasing along with the price. So we have been able throughout this timeframe to at minimum maintain our gross merchandise margins and price accordingly to do so.

One of the benefits that we also have is that in the jewelry business it's a slower turn business. And with our inventory mechanisms worked on an averaging basis meaning that you can see the commodity cost increase is coming at us, in advance to when they are actually going to occur. So we have time to this plan and stage or place it accordingly so that we can built that into the consumer. The other thing that we do is that we only to maintain an opening price point in a range of various price points. So that as the prices are increasing the consumer still has a variety of choices. So you can choose from a continuum along the pricing scale from say something that costs $89 or $79 up to thousands of dollars depending upon how much money the consumer has to spend in a store.

So we make sure that those price points of each and every level that meets the needs of the consumer that we are dealing with this commodity inflation. So that's how we dealing with that and we are dealing with it very effectively. From a perspective of SG&A our SG&A expenses are always very well controlled. However, this year in particular we did take the opportunity to let's say correct some things are have been taken away from people within our company during the recession. Things like salary increases and certain benefits that people were restricted during the recession.

We felt that since the Company is doing better it was appropriate to add that back into our cost structure, which did increase some of our SG&A spending on a planned basis for this year as well as some increases in advertising as we thought will be appropriate. In order to completely drive the market share gain that we've been able to do it a year. So we have been very careful and very prudent about planning exactly what we are going to do to SG&A we laid that out this year and told people that our SG&A percentage should be relatively consistent with those of last year and the reasons that that happened and yes indeed what exactly has happened.

So we have seen gross margins improve with merchandise gross margins being relatively stable and actually increasing a little bit in the first quarter. Leverage occurring on occupancy cost because it's a relatively stable cost giving the high level of comp we have been able to experience.

And improvement in bad debt all of which go in our gross margin lines so that's all serve to drive our gross margin forward in the first quarter. Continuing the trend from last year we have experienced more or less the same thing.

So I believe that all our cost are being controlled, we face the same pressure as other people, you know healthcare costs are going up, operating costs are going up. But we're able to carefully monitor, we are putting in a lot of technology to improve our efficiency whether it is in credit collection area, or in inventory area, across the spectrum of what we are doing we are all about continuous improvement and bringing some of our operating cost into a more efficient level over time. So the combination of that and our pricing capability has enabled us to handle very well, a very difficult commodity inflation and cost inflation environment.

Neely Tamminga - ***Piper Jaffray - Analyst,***

I would love to open the floor for some questions. Is there any other questions?

QUESTION AND ANSWER

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Michael Barnes - ***Signet Jewelers Limited - CEO***

Well first off let me say that I am very pleased with our business in UK especially in the environment that we are in right now. It is one of the weakest consumer market that they have seen in many, many, many years and obviously it has not recovered near to the extent that the US has. They've had value added tax increases two years in a row of 2.5% per year. So that's 5% of the sale, which is built into the price of the goods going directly to the government that wasn't going there before. They've had to overcome that, they have the same price pressures that we've had obviously we had that globally both in UK and the US And it has just been a tough environment from the standpoint the government has been announcing all austerity measures you know the confidence of the consumer is certainly weaker, having said all that as I said I am very pleased with the way that we have performed in that market. If you look at our numbers from last year, we had an 8% operating income in the UK and we had a 25% return on capital employed in the UK.

Those numbers are pretty good you know a lot of people would take those numbers to the bank every year if they could. Certainly it's not as good performing as what we saw in the US or what the UK has done in the past. But I think that we are positioning ourselves very well for the future; we are making a lot of investments in the UK market. We are doing the same things that we are doing in the US, there's only a few stores that they were able to open based upon real estate that meet our criteria. But we are doing a tremendous number of remodel and you know we've slowed down a little bit during the recessionary time period both in US and the UK. So we are kind of eliminating that backlog now we are getting some great stores remodeled out there, we are expanding some stores, we are expanding space in certain major doors that we have and we are doing some resites some relocations of certain stores as we have found some better real estate to locate to. So it is a business that has been tough, but it's highly profitable, positive cash flow good returns on capital and we are excited about it. I personally think you have a better chance of taking market share when things are tough then when they are good. And so you know with the strength of our company we are also investing in the business and really driving it forward and we are excited about the future there.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Michael Barnes - ***Signet Jewelers Limited - CEO***

Yeah, but you know obviously you have to compete against whoever you are playing out there and you know what we do is we focus ourselves on our own business and how we can strengthen it and gain all the competitive advantages such as what we already have. And really just pound

those competitive advantages and you know have the best merchandise, the best brand, the best associates, store managers, regional managers that's really where our focus is.

And we think that we have best in class in all those different categories, you know we feel like the staff that we have in the stores is really driving the business home. They are giving the best customer experience possible to the customers that you know those visiting our stores and we don't really focus on what you know anyway the other competitors by name or doing other than watching you know competitively how they're pricing goods and keeping up with different initiatives that they make be driving as well to make sure that we are more on top of our game. So that's really where our focus is.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Michael Barnes - ***Signet Jewelers Limited - CEO***

You know the business; the bead business right now is continuing to be extremely well for us. And we are still in fairly early stages of that business I think, certainly the Charmed Memories is still on a non-comp basis for most of the, the first three quarters of this year. So we have some great opportunities there is rolled out in the fourth quarter of last year and doing extremely well. You know that's part of the fashion business out there, that I think is kind of an evolution of this industry and driving it not only we have the fashion jewelry but we have another part of the fashion jewelry, which is the bead business. It is something that we will have to watch like all the other businesses by the nature of it and again something I'm very familiar with for a long time. When you are in the fashion business you've got to watch the trend and a lot of them are cyclical and they go up and go down I've seen it in the watch business for a very long time.

And as they go up you get behind them you do it quickly, you do it faster than the competition and you drive that business you know to profitability very fast. And if something starts trending down then you deal with it the same way, you pull back and you see what else is trending up you get behind it. But I think all of these categories included the bead they are going to be around for a very long time to come. And then they may cycle up a little bit and cycle down but that is the job of all of our merchants within our organization to know what is selling get behind it and make sure that we have the appropriate you know offering for our customers.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Michael Barnes - ***Signet Jewelers Limited - CEO***

Yeah, if you look at the marketing spend that we have planned for this year, we have stated that we expect it to be between 6% and 6.5% sales. I believe last year was right at 6% sales. So it could be up slightly this year based upon that we certainly did spend as Ron mentioned a little bit earlier some additional advertising money in the first quarter. We've done you know some testing, we take advertising very seriously we are very scientific about it you know we have test markets. And we have control groups and many ways of reading what's successful and what's not which has been one of the reasons that we have driven that to be a big part of our business and our success. So we will continue to spend at those levels of 6% to 6.5%, that's on a full year basis, of course there are differences within quarters. But I would expect to see you know that much spent, which is probably going to be slightly above last year's level.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Michael Barnes - ***Signet Jewelers Limited - CEO***

We are very cognizant about the cash on our balance sheet and we are looking at all opportunities to invest that to the best return for all of our investors. Obviously, the first place that we are going to look at is investing back into our business, so we'll continue to drive all the organic

initiatives that we have out there. We'll continue you know updating our stores looking for new real estate as it becomes available. We have said that as far as strategic opportunities are concerned, we will be very open and opportunistic looking at things that we feel fit our business model very comfortably and that there could be accretive to our company over the long term. And would meet the type of investment returns that we would expect so we don't really address exactly what are we doing you know today versus next month versus the month after. But we are open to opportunities we will continue to invest in our current initiatives that we are driving. And you know we are open to opportunities in potentially different markets than where we exist today as well.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Michael Barnes - ***Signet Jewelers Limited - CEO***

Yeah, I think that we are too, and in fact I've started seeing this long before I came to Signet because all the certain brands started getting into jewelry on the fashion side of things. And then we started seeing that you know here with the precious jewelry, the fine jewelry, the diamonds and the precious metals. It's starting to happen here and I think it is something that is going to continue to grow; I think brands will become more important not less important overtime. There is tremendous amount of communication in the world today and we did it in the United States with everything that's going on with the Internet with social networking the amount of communication that people have with one another. They are all going to gravitate towards brands that are meaningful to them and speak to what is important to them.

And I think we are going to see more of that as we go a long, it is a definite difference in the jewelry business versus the watch business you know watches have always been about brands but they were somewhat technical in nature even on the fashion side and therefore it was primarily a branded business not a generic or private label type business. And now we are starting to see that happen with jewelry and these brands tend to have something what they stand for as I mentioned some of the atributes earlier. You know even on the fashion side, which I didn't talk about much you know if you look at Jane Seymour Open Hearts you know it's all about the message that she is creating out there. Open your heart and love can find its way in and that is a message that resonates with the consumer with our customers and I believe that as more brands come on line and become popular we'll see them bringing their message to a broad audience and it will continue to happen.

Neely Tamminga - ***Piper Jaffray - Analyst,***

One final question. I do want to ask about social media, so when you talk about your advertising spend how's it's expected now to large in the catalog thing so I think you guys do and with those strategies that's really redeploy some of that into other forms of market.

Michael Barnes - ***Signet Jewelers Limited - CEO***

Well if you look at our web initiatives in general it's something as Ron mentioned earlier, that's one of the areas when I came in and started you know drilling into what the business looks like I felt like you know while we had great websites out there and we have done a fantastic job with it. We probably should be using further and faster. And so we are putting a lot of investment into you know building the web getting into the social media part of that web and really driving that. Because that is the wave of the future that train has left the station and it's not coming back.

So we all need to embrace it and get behind it and make sure that we are best in class in those areas compared to our competition and that is our goal and that's what we are working on, we are happy with where it is at and we are still going to continue driving it. I think that you will see, you are going to see us spend advertising dollars in many different ways you know a lot of national television because we have the skill to do that and most people don't. And we think it drives a great competitive advantage so we will continue spending the lion's share on television but we are going to invest in the web not only in e-commerce but also and have our advertising on the web and how we are reaching people and speaking to them and communicating back and forth in a dialogue with them through social media. So those are you know two of the basic things that we are going to be driving towards.

Neely Tamminga - ***Piper Jaffray - Analyst,***

Well that's about all the time we have so thank you so much for joining us today. Thank you.

Michael Barnes - *Signet Jewelers Limited - CEO*

Thank you very much. Thank you. I appreciate it very much and thank you all.

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