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EDITED TRANSCRIPT

SIG - Signet Jewelers Ltd Q3 Fiscal 2013 Results Conference Call

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OVERVIEW:

SIG reported 3Q13 total sales of $716.2m, net income of $34.9m and diluted EPS of $0.43. Expects 4Q13 EPS to be $1.95-2.10.

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PRESENTATION

Operator

Good day and welcome to the Signet Jewelers third-quarter 2012 results conference call. Today's conference is being recorded.

At this time, I would like to turn the conference over to James Grant. Please go ahead, sir.

James Grant - *Signet Jewelers Ltd. - VP of IR*

Good morning and welcome to our third-quarter earnings call. With me today are Mike Barnes, CEO, and Ron Ristau, CFO, as well as Tim Jackson, Investor Relations Director. The presentation deck we will be referencing is available from the webcast section of the Company's website, www.SignetJewelers.com.

During today's presentation we will in places discuss Signet's business outlook and make certain forward-looking statements. Any statements that are not historical facts are subject to a number of risks and uncertainties and actual results may differ materially. We urge you to read the risk factors, cautionary language, and other disclosures in the annual report on Form 10-K that was filed with the SEC on March 22, 2012. We also draw your attention to slide number 2 in today's presentation.

I will now turn the call over to Mike.

Mike Barnes - *Signet Jewelers Ltd. - CEO*

Thanks, James. Good morning, everyone. We delivered record earnings in our third quarter, driven by strong execution of strategies, gross margin leverage, and receivables productivity. For the quarter, Signet same-store sales were up 1.4%. The US delivered a 1.2% comp store sales increase compared to 13.9% last year, which was boosted by a one-off watch clearance event. The UK comps were up 2.3% in Q3 this year, the division's fourth consecutive positive comp.

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Signet operating margin was 7.3%, which was an increase of 130 basis points from the prior year. Operating income was $52.5 million, up $10 million or 23.5%. Diluted earnings per share were $0.43, up $0.13 or 43.3%. Overall it was an outstanding quarter.

I would like to thank all the Signet team members for contributing to these results.

Now before I jump into the detail on the US division, we would want to offer our sympathy to those that were impacted by Super Storm Sandy in the US and offer our wishes for a speedy return to normalcy. This storm created some initial disruption and November thus far has been challenging. Nevertheless, with the majority of sales ahead of us, we are well prepared for the holiday season.

Turning to the US, total US sales were $575.6 million, up $12.6 million or 2.2% driven by fashion jewelry and bridal, as well as branded and exclusive merchandise. Kay increased same store sales by 5.5% on top of the 13% growth last year. Jared comps were down 4.1% following an 18.3% increase last year, which included a large watch clearance event. That event and the discontinuation of the associated line unfavorably impacted the Jared comp this year by 9.6% in the quarter and US division comps by 3.5%.

So excluding this impact, sales growth in the third quarter of this year in Jared and Kay were approximately equal. Overall US same-store sales increased by 1.2% in the third quarter of fiscal 2013 compared to an increase of 13.9% last year. Operating income was $67.9 million, up $11.5 million, a 20.4% increase.

I will now take you through some of the key initiatives in place to drive our holiday season business.

As we discussed on the second-quarter call and further communicated at our investor day, we believe we are well prepared to win this holiday season. We have got many exciting new products that are well tested and in store. Most of these programs were rolled out during the third quarter and so their first full quarter of impact will be this fourth quarter.

In particular, we have new merchandising programs including Artistry Blue Diamonds and Shades of Wonder, which address the hot industry trend of colored diamonds. In addition, we have fresh line extensions such as Neil Lane Design and Jane Seymour Family collection.

Let's not forget that the Leo Diamond, Neil Lane Bridal, Tolkowsky, and Le Vian continue to be strong business drivers for us. Also our watch business excluding Rolex continues to be very strong with some brands comping at double-digit rates.

We increased our marketing investment this year as well with new campaigns to deliver more impressions over the holiday season through television and also through digital media tools including our new websites, social media, and mobile capabilities. We have enthusiastic well-trained sales teams ready to support our merchandise initiatives who are better equipped than ever before to provide customers with a great experience. I will talk a little bit more about that in a moment.

I am very excited about the number of digital initiatives underway to drive growth across all of our selling channels. E-commerce sales were up 39% in the US for the third quarter and that was without the benefit for the majority of the quarter of our new Kay and Jared websites launched in October. The new sites have greatly improved functionality and product search and navigation as well as increasing product selection by 10 times. We have had strong positive consumer response thus far.

In social media, we are pleased with our customer response to the content we are delivering. Our fan base and followers continue to climb as holiday promos are underway and the social media outlets are driving traffic to our e-commerce sites.

Fully transactional enhanced mobile sites for Kay and Jared have recently gone live and are performing well. These not only make it easier for our customers to complete their transactions on their mobile devices but also offer our entire product range right there in their hands in a format much easier to maneuver.

This commitment to sales-enhancing technology is also reflected in store with all Kay and Jared stores now having digital tablets this holiday season. These are key selling tools for our stores and they have been very welcomed by the teams in the field.

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These are all steps along the way to achieving our goal of becoming best in class in all aspects of the digital environment. This is a channel within the jewelry market that we have historically been underrepresented but this year we expect to achieve digital sales of more than $100 million in the US alone.

As we announced last month, we acquired Ultra Stores and its 140 locations in an all cash deal. The acquisition is expected to add $40 million to $45 million to our fourth-quarter sales this year and have minimal impact to earnings including acquisition costs.

Today I will share with you a little more color on our long-term strategy for Ultra. As we move into next year, you can expect us to take advantage of our new position as a major player in the outlet channel. Our strategy is to leverage the Kay brand with Ultra's outlet expertise. We have already begun the process whereby we will convert the majority of the stores to Kay outlets Kay Outlets driving increased productivity and further market share gains. We expect to complete this transition by mid-fiscal 2014.

Short-term, we are highly focused on executing in the all-important holiday season. No changes, no distractions. It is all about delivering a great customer experience during this critical time and while it has only been a few weeks we have been very pleased with the continuing performance of Ultra. The transition is anticipated to be accretive to earnings by the fourth quarter of Signet's fiscal 2014.

Now turning to the UK, same-store sales increased by 2.3% driven primarily by strong performance in the prestige and fashion watch businesses. Total sales were $140.6 million, down $6.9 million or 4.7%. We again outperformed the nonfood retail sector as a whole according to the British Retail Consortium.

The operating loss was $5.5 million or 3.9% of sales, a slight decline from last year. At every level of the business, we are totally focused on the seasonal sales in front of us and we have developed strong initiatives to help us drive the best possible results.

In the UK, as in the US, we feel well positioned for the fourth quarter in a continuing tough economy. We have a record level of new merchandise in our stores. In H.Samuel, we have a new exclusive range of beautiful and affordable fashion jewelry that bond the precious metals of gold and silver sold under the brand 'Together'. In addition, the Forever Diamond, a solitary engagement and jewelry program, has a promising fresh product lineup and bridal sets are becoming increasingly popular in the UK, which we're well-positioned for.

In Ernest Jones, we have a number of sales catalysts as well. New and improved merchandising for many of our successful watch brands, new Italian fashion jewelry plus additional rollout of Le Vian in the fashion space and certain newly introduced US bridal brands such as Tolkowsky and Neil Lane to go along with the successful Leo Diamond already in store.

We have also recently launched an improved inventory management system that is helping us meet customer needs more effectively in a much more efficient manner and is also expected to improve our inventory turn. E-commerce sales were up a strong 25% in the third quarter and we continue to build on our digital capability.

We have refreshed the Ernest Jones website and expanded the merchandise selection for both Ernest Jones and H.Samuel. We are increasing advertising investment again this year and as in previous years, testing some new advertising strategies.

Our customer relationship management programs across both brands remain strong as well. Our UK team members are fully committed to driving a strong performance in the fourth quarter.

With that, I will turn the presentation over to our CFO, Ron Ristau.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Thank you, Mike. I will now give further detail of our financial performance. As Mike indicated, total sales for Signet increased 0.8% to $716.2 million. Comp store sales increased 1.4% versus an increase of 10.6% in the comparable quarter last year. In the US, total sales increased 2.2% to $575.6

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million, primarily reflecting comp store sales growth of 1.2% versus a 13.9% increase last year. The one-time watch event in fiscal 2012 and the discontinuation of the associated watch line reduced US same-store sales by 3.5%.

In the UK, total sales decreased 4.7% to $140.6 million. Comp sales increased 2.3% while but unfavorable effects of reduced square footage and foreign exchange drove the total sales decline.

Signet operating income increased by $10 million to $52.5 million, up 23.5%. Operating margin was 7.3%, up 130 basis points. The major factors driving this increase were US gross margin and other operating income.

Signet gross margin was $235.4 million, an increase of $5.5 million. The gross margin rate was 32.9%, up 50 basis points. Gross margin in the US increased $7.8 million driven by a favorable gross merchandise margin increase of 90 basis points. This was due primarily to merchandise mix including the impact of the one-time watch event last year which suppressed margins last year.

The US net bad debt to US sales ratio was flat at 5.4% on a 12% increase in the AR balance. The portfolio performance remains strong.

Gross margin in the UK declined by $2.3 million, reflecting lower sales and a gross margin rate decrease of 30 basis points. The decrease was a result of a decline in gross merchandise margin of 130 basis points caused by customers' preferences for promotional merchandise. Partially offsetting the decline were favorable store occupancy expenses due to store closures and negotiated rent reductions.

Selling, general, and administrative expenses were $222.6 million, and as a percentage of sales increased 20 basis points to 31.1%. This was primarily due to acquisition-related costs of $2.5 million and administrative cost increases supporting strategic initiatives partially offset by a $3.9 million favorable settlement from the De Beers antitrust litigation.

Other operating income was $39.7 million, up $7.5 million versus last year, reflecting interest on the higher level of accounts receivable and a change in the mix of finance programs selected by customers. This had a 100 basis point favorable impact on operating margin.

Our income before income tax was $51.6 million, an increase of $9.5 million or 22.6%. Taxes for the quarter were $16.7 million resulting in a net income of $34.9 million and diluted earnings per share of $0.43, up 43.3%.

The weighted average fully diluted number of shares for the quarter was 80.9 million, down from 87.1 million last year as a result of the share buyback. For the year, we expect the tax rate to be 35.4%, consistent with fiscal 2012.

Now turning to the balance sheet, net inventories at October 27, 2012 were $1.5085 billion, reflecting our seasonal build. This represents an increase of 6.7% from $1.414 billion a year ago. The increase was primarily due to higher commodity costs and strategic investments, for example, our rough diamond sourcing initiative, partially offset by management access to improve our sector-leading inventory turn.

Total net accounts receivable at the quarter end were $998.2 million, an increase of 12%. This was caused primarily by our sales increases and the in-house credit participation rate. Year-to-date, credit participation was 59% of US sales compared to 57.2% at the end of the third quarter fiscal 2012. The year-to-date credit participation rate is at its highest level at the end of the third quarter due to a higher penetration of bridal business in the first nine months. This is historically lower in the fourth quarter.

For instance, the annual credit participation rate was 56.1% for fiscal 2012. Lastly, the credit approval rate for the third quarter this year was down 190 basis points.

As indicated earlier the third-quarter net bad debt to US sales ratio was 5.4%, flat to last year on a 12% higher receivable balance. The credit portfolio continues its strong performance.

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The third-quarter collection rate was 12% versus 12.2% last year as the time frames for collection extended slightly due to the mix of programs selected by customers, this primarily being regular credit terms versus a 12-month interest-free program as the former requires no down payment and allows longer payment horizons.

Other operating income, which represents primarily interest on the portfolio, increased $7.5 million to $39.7 million as a result of the increase in accounts receivable and the mix of programs selected by customers as I mentioned previously.

Turning to capital spending, for the year we now expect capital spending to range from $155 million to $160 million. The high end of that range is down a little from previous estimates due to a variety of small changes mostly related to full and minor remodels in both the US and the UK. Year-to-date capital spending was $100.9 million, an increase of $27.9 million for the comparable period last year as we've increased our new store remodeling and IT investments.

We expect to open 49 new stores and perform major remodels in about 75 stores this year. Store closings are planned at 57 and primarily reflect the closure of regional stores in the US and 29 UK locations.

We have added 107 stores through the Ultra acquisition and therefore we should end the year with 1,952 stores. Including 160,000 net selling square footage in Ultra locations, the total net selling square footage at the end of the fourth quarter is expected to be 3.13 million excluding 33 licensed Ultra jewelry departments. This represents a 7.9% increase for Signet overall, a 10.5% increase in the US and a 3.4% decrease in the UK compared to last year-end.

Lastly, we are providing fourth-quarter guidance because the fourth quarter of this year has a number of different components we want to ensure are clear. This is actually the first time we have provided fourth-quarter guidance.

Our guidance for the 14-week fourth quarter is for same-store sales growth in the low single digits and earnings per share of $1.95 to $2.10. Now the pieces so you can understand better.

For the 13-week period, we are guiding to same-store sales growth of low to mid single digits, which drives our earnings per share of $1.98 to $2.15. We then have the 14th week impact. As we've previously indicated, while this additional week is expected to increase our total sales by approximately $48 million to $52 million, this will however have a negative impact on same-store sales for the comparable week last year. Sales were $89.3 million including a promotional event we had on Mother's Day. This reduces same-store sales guidance the low single digits we mentioned and adversely impacts earnings per share by $0.02 to $0.03 in the quarter.

Finally, the Ultra Stores acquisition is expected to add $40 million to $45 million to fourth quarter sales, have no impact on same-store sales, and to unfavorably impact earnings per share by $0.01 to $0.02 due to short-term acquisition costs. For clarity at year-end, we will provide information on a 52- and 53-week basis and on a 13- and 14-week basis for the fourth quarter.

Thank you. I will now hand back to Mike.

Mike Barnes - *Signet Jewelers Ltd. - CEO*

Thanks, Ron. Just a brief clarification. The event that Ron was referencing in the 14th week was actually Valentine's Day, just to be clear on that.

In summary, we had record third-quarter earnings and remain focused on delivering an exceptional customer experience with exciting merchandise programs, new enhanced marketing programs, and further development of our digital sales capabilities, as always driven by our talented team.

We would now be pleased to take any questions that you might have.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Oliver Chen, Citi.

Oliver Chen - *Citigroup - Analyst*

Congrats on solid results. Regarding -- could you brief us on what you are seeing in the marketplace with commodity costs and how that may impact your decisions going forward? Also will sales mix continue to be a positive driver to gross margin? It looks like the gross margin comparisons ease.

As a follow-up, the inventory growth on a year-over-year basis seemed to pace above sales growth. Could you just explain that line item and how should we think about inventory going forward? Thanks.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Okay, let me take -- there are three components of that question. I will start with the inventory question. Number one, our inventories are up a little better than 6%. That is actually down from what it had been running in the first two quarters of the year because of some opportunistic purchases we made at the end of last year in diamonds. We would expect that our inventories will get closer to sales growth by year-end.

I would point out that included in that we've got an increase in commodity costs and we do have some additional inventory right now because of our rough diamond sourcing initiative that we've spoken about and that's about $32 million of the increase in the inventory. So we are well pleased with the inventory.

We still have and continue to have a sector-leading turn and we've seen further improvements in our turn ratios so our inventories we believe are well-positioned as we go into year-end.

Commodity costs have been certainly slowing somewhat. We've seen some slight declines in diamond prices but not significant. The diamond market again I point out is bifurcated with more movement at the higher end than it is in the diamonds that we traditionally use in our business so while we have seen some reduction in pricing, it has not been significant. And our expectation for the future at least as we talked into the fourth quarter is that our margins will not be affected that greatly by this. We might see some pickup in the US gross margin in the fourth quarter and we will see what happens as we go forward because unless these changes are long-term and sustained, Oliver, we really do not adjust our pricing strategy and we haven't seen anything that dramatic at this point in time that would lead us to change our strategies.

Oliver Chen - *Citigroup - Analyst*

Will sales mix be a positive factor to consider as you were able to do that in 3Q?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

In Q3, it was primarily driven by the Rolex watch event. That's why it's so large in the third quarter because last year at Rolex while we sold a lot, it certainly was sold at low margins because we were promoting to basically exit that line. So I don't think it will be as great as it was in the third quarter although we are expecting again some very slight increases in our margin in the fourth quarter.

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Oliver Chen - *Citigroup - Analyst*

Okay, and our final question in relation to how should we think about the other operating income line? Will that growth in that on a year-over-year basis continue to outpace total revenue growth as bridal penetration changes or should we think otherwise?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

I think that the rate of increase that we experienced this year I do not believe will -- we're not really going to talk about next year because we are not ready to do that but I would not think the rate of that increase would continue at the same rate, so I would think would be more normalized. I think we have seen the major adjustments occurring this year, so I would expect it to continue to grow but not at the same rates as this year.

Oliver Chen - *Citigroup - Analyst*

Okay, great. Thanks. The product looks great for holiday so good luck.

Operator

Rick Patel, Bank of America.

Rick Patel - *BofA Merrill Lynch - Analyst*

Thank you. Good morning, everyone. Can you just talk about the strategic rationale behind the Ultra acquisition? I guess the question is why now and why not approach it organically through expanding your Kay outlet stores?

And then secondly, what do you plan to do with Ultra's shop in shops? Will you rebrand these as Kay also or do you intend to keep them open as is?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

Sure, I would be glad to talk about that. We do see this as a great strategic move for us, quite frankly. We have been the market leader in the mall for many years now and frankly in the channel of outlet malls, we have been running a poor third place in my opinion and we had not focused enough on it over the years and we wanted to make this a core strategy of ours. We have been opening stores over the past five years but at the rate that we could get the quality of real estate that we demand, it would have taken us a number of years to get to the number of stores that we were able to get to with this acquisition.

In acquiring 107 new stores, most of those being in the outlet mall channel, we immediately become a major player. We are able to almost immediately leverage the Kay branding that we have got out there as we are going to turn most of these into Kay outlet malls and get the leverage off of that and the productivity that we see in Kay outlet malls as well and we just think it's a big win for us.

As far as the licensed departments that we are operating with Ultra primarily in the Burlington Coat Factory stores, we are going to continue to operate those and take a good, hard look at that business. We think that there is an opportunity there. We like what we have seen and we will see where that goes, but for now we will continue to operate those as Ultra licensed departments within those stores.

Rick Patel - *BofA Merrill Lynch - Analyst*

All right, that's helpful. And then can you give us some insight on your monthly cadence for comps throughout the third quarter? I'm curious if all three months were relatively steady or if you saw weakening as you exited the quarter?

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And then just as a follow-up, a question on the impact of the hurricane, I know the bulk of your sales happen after Black Friday but can you put the first three weeks of November into context for us as to how much they represent for the quarter? Is it north of 10% of sales? And what is your level of confidence at being able to recapture these sales once the holiday shopping period begins?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

We don't really break down our comps on a monthly basis. We give them quarterly, but we feel very strongly that we had good comps in the third quarter. On a normalized basis, we saw Kay at 5.5% and as we showed, Jared without the one-time event that we had to anniversary would've been in a similar territory there. So we felt like we had good comps in the third quarter.

The fourth quarter has started off a little bit challenging. The storm came right at the beginning of the quarter and quite frankly it did have a major impact. We have done some analysis on this and we feel like the storm in the first couple of weeks alone probably cost us somewhere in the neighborhood of $5 million to $6 million in sales and we had even analyzed on a state-by-state basis impacted states versus non-impacted states and frankly there's a huge difference in the sales numbers there running at about 1000 basis points, so certainly it had a big impact.

There was other noise out there as you know, Rick. The election was going on and there was a lot of worries about the economy and fiscal cliff and all of that, so I wouldn't put it all on the storm. We're just saying it started off a bit challenging.

You are right, though, the biggest part of our season is ahead of us and we are very excited about the preparation that we have done for it and the great merchandise that we've got out there and the fact that the team is very well prepared to execute. So we will see what the season brings. We have done everything that we can to be the most prepared that we have probably ever been and we will see how it goes and we look forward to getting into the meatier part of the season.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Rick, the jewelry business as you know, is much more back end loaded than many other businesses when you look at the patterns during the holiday season. So the last three weeks leading up to Christmas are really where the lion's share of sales take place, so we are -- those are the key weeks for us.

Rick Patel - *BofA Merrill Lynch - Analyst*

Thank you very much and all the best for holiday.

Operator

Jennifer Davis, Lazard Capital Markets.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Good morning and congratulations on a great quarter. My first question is around Ultra. I think that you said you are going to convert or you already began to convert some to Kay stores -- or Kay Outlets. How many will be converted before holiday?

Then what kind of -- how should we think about the merchandise mix at the outlet? How much is currently or how much ideally should be kind of made for outlet or kind of deep value merchandise? How much is clearance from full price stores? How much is kind of crossover product that's also carried in full price stores?

I think that there's a couple of Ultra Stores that are not outlet stores. Wondering what your plans are for those? Thanks.

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Mike Barnes - *Signet Jewelers Ltd. - CEO*

Thank you, Jennifer. Actually for holiday, as I said in my prepared remarks, basically we don't want any distractions so we've told the team stay focused, run your business. We are not going to change any of the stories into Kay before holiday. Most of that is going to take place mid next year. That's what we are targeting. We have a lot of systems implementations to get done and some transition work to do but by mid next year, we should have transferred most of those stores into Kay outlet stores.

In terms of our strategy for outlets, I think that's a great question because one of the things that we had been focused on was to really improve and develop a stronger output strategy in general and this just gives us the opportunity to leverage that even further. So we are doing a lot of work right now on how to optimize and maximize the business that we can do in our outlets and even though we have great productivity in the Kay outlets we have been operating, we believe there's more upside to that. We believe that we can operate more effectively in the outlet channel and so it's something we are putting a lot of work into.

I couldn't break it down in terms of the merchandise mix for you right now but as we continue to develop and evolve that, we will put some more information behind that in the future.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Okay, did I misunderstand you? I think you said you had already begun to convert the majority of stores to Kay outlets.

Mike Barnes - *Signet Jewelers Ltd. - CEO*

We have begun the work to make those conversions happen.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Okay, the behind the scenes, some of the behind the scenes?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

Yes.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Okay.

Mike Barnes - *Signet Jewelers Ltd. - CEO*

A lot of behind the scenes, a lot of IT work etc. going into that. So we will be there by mid next year certainly and we're looking forward to it.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Okay, great. And what about those couple of stores that are not outlet stores?

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Mike Barnes - *Signet Jewelers Ltd. - CEO*

You know, we're going to continue to operate those. They happen to be great stores in great locations and they are doing well.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Will they be converted to Kay's also?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

I think the plan would be that we would most likely convert those to Kay but we're still studying that as well.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Okay, great. Any update on Rio Tinto in the rough diamond initiative? What percent of your diamond purchases will be from that?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

Well, it's still a non-material number and we don't really disclose the exact percentage. But that is actually going pretty well for us right now. We have a great relationship with Rio Tinto. We have continued to work with them throughout the year and we are starting to find some other synergies as we expected to in that part of the business and some other potential partnerships as well.

So it's something that continues to move along. It is a very long-term strategy for us. It's very important to the future of our Company but it still continues to be non-material at this time.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Great, thanks. One more quick one I'm going to squeeze in, I think you said you invested in some inventory. I didn't quite hear it or I missed part of it, some inventory management systems? Could you tell us a little bit about that or did I mishear that?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

I think what Mike referenced in his remarks, in the UK, we have some new systems which help us to identify stock availability in each store that were installed in the UK, which we believe will help us manage the UK system better. We always every quarter seek to improve our inventory turn on an overall basis. We were successful in doing that again this quarter and that's one of the reasons that our inventories are under such good control this year.

The 6% increase that we're experiencing right now, which is down from 9% increase in the first and second quarter of last year is primarily the result of the seasonal build, the build in commodity costs, and we do have in there about $32 million worth of inventory on our rough diamond sourcing initiative that -- because of a slight inventory build as we go back another level into the purchase of diamonds, so (multiple speakers)

Jennifer Davis - *Lazard Capital Markets - Analyst*

Okay, great. Thanks and best of luck.

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Operator

David Wu, Telsey Advisory Group.

David Wu - *Telsey Advisory Group - Analyst*

Hi. Good morning, everyone. First, I was wondering if you could talk about sort of how much of an impact from Sandy are you baking into your fourth-quarter comp guidance? If you were to exclude the impact from Sandy, would your fourth-quarter comp including that 53rd week be more up in sort of the mid single digit range versus low single digits?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

I will start off and I will let Ron jump in there and give maybe more of the detail. But as I characterized a few moments ago, the Sandy impact we have estimated the first couple of weeks of the impact were somewhere between $5 million and $6 million in sales and certainly we had that information at the time that we put together the guidance that we released. So we did contemplate those numbers as we put that guidance out there.

I don't know if you want to talk any more in detail, Ron, on that?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Certainly we have included it within the concept. It is difficult to break out on an exact basis what will happen. We hope that in the Sandy areas that the areas will recover. But that may prove optimistic. Our sales in those areas will recover as the people in those areas recover. So we understand that people first have to take care of things that are important to their families and we will see how that goes.

David Wu - *Telsey Advisory Group - Analyst*

Great, and on the watch business, I know you mentioned it was strong in both the US and the UK. Can you perhaps update us on the testing as the Michele watches, how that's progressing and how the in-store boutique for TAG Heuer in the US and Omega and Breitling in the UK are performing and your plans for future shop in shops?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

As you know, we just expanded the TAG Heuer boutiques in the US and I don't have any updated information on that at this time but I will update that for you at the holiday trading statement when we come out with that.

As for Michele, we started with I believe it was 27 Jared stores in the fall of last year. We expanded another 14 doors in March and now we have expanded an additional 17 doors in October so we're now up to 57 doors in Jared with that. So obviously as we continue to expand, we have been fairly pleased with the results that we see there.

We've also expanded our test of Gucci watches which started in 26 Jared stores back in the spring and we have expanded to an additional 39 stores, so they are now also in 57 doors.

So the watch business has continued to be strong. As I mentioned, we've seen some double-digit comps on some of the brands out there and I wouldn't go through it brand by brand but we've been very happy with the state of the watch business in both the UK and the US.

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As you know, it's much more material in the UK, where it is approximately a third of our business, and it's still just kind of in the higher single digits, mid to high single digits in the US.

David Wu - *Telsey Advisory Group - Analyst*

Would you say as a percentage of your overall product mix that watches is increasing versus last year now?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

I would say no, it's relatively stable in terms of the actual sales mix. The business is great but it's not materially changed in terms of the percentage of mix.

David Wu - *Telsey Advisory Group - Analyst*

Okay. In terms of some of the new proprietary launches, the Neil Lane Designs and Shades of Wonder, I know they've recently launched and can you talk about perhaps the initial sort of sales performance there?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

You know, we tested Neil Lane Design back in the spring and we were extremely pleased with the tests that we had there. Otherwise we would not have rolled that out. We have now rolled that for the fourth quarter to all Kay and all Jared doors. So we are very happy with it. Obviously it's still early days and we will continue to evolve the merchandise as we move forward but it has been very strong. We think that there's a big opportunity for it in the fourth quarter and beyond.

The Shades of Wonder has done very, very well for us. The Artistry Blue Diamonds, both of those really work on what's happening with color out there in the marketplace and we've seen a lot of color being very strong as a trend. So we think that we've got the merchandise right and we have made some great extensions and some great new brands out there and we are very happy with it.

David Wu - *Telsey Advisory Group - Analyst*

Excellent, and just lastly on the credit business I think, Ron, you mentioned that approval rates were down versus last year. I was wondering if there are any sort of changes to call out maybe with respect to the approval process or the scorecards?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

No, there was absolutely no changes in the approval process or scorecards. It just happens to be how it works. We do not -- as you know, I always make the point that we do not make adjustments to that on any kind of -- any basis, really. So, okay?

David Wu - *Telsey Advisory Group - Analyst*

Excellent, thank you very much.

Operator

Bill Armstrong, CL King.

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Bill Armstrong - *CL King - Analyst*

Good morning, Mike and Ron. On the outlet side, can you remind us how many Kay outlet stores there are now? Is that the 181?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

We are 26 (multiple speakers) there is about approximately -- when we are done we will have approximately 133-ish because right now we have 26 Kay outlet stores.

Bill Armstrong - *CL King - Analyst*

Okay, 26 now. So I am not sure if you disclose this in terms of sales per store on the outlet, Zales is doing about $1.4 million and it looks like Ultra is doing about $1.3 million. How would -- how do the Kay Outlet sales per store compare with those -- that range?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Well, we have it but we are doing -- we haven't disclosed it but we are probably a little bit better than those numbers.

Bill Armstrong - *CL King - Analyst*

Is the idea that with the advertising support you can increase the productivity of the Ultra Diamond outlet stores?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

That would be the working business theory, yes.

Mike Barnes - *Signet Jewelers Ltd. - CEO*

Especially as we transfer them into Kay brand.

Bill Armstrong - *CL King - Analyst*

Right, and most of my other questions were answered. Just one other question on credit. Could you maybe elaborate a little bit on the mix of credit programs that consumers are migrating to that's helping to increase your credit income?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Yes, so as I indicated what's been happening is people are essentially opting more for our normal credit terms than they were our 12-month interest free program. That enables them to put down a less of a down payment and take a little bit longer to make those payments. So that's what people are doing and that's what's driving the favorable mix in the credit program.

Bill Armstrong - *CL King - Analyst*

Okay, is there a risk of higher default rates as a result of that?

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Ron Ristau - *Signet Jewelers Ltd. - CFO*

No, not at all. There's no impact on default rate. The quality of our portfolio as I indicated remains very high and the performance has been very gratifying. Again once again, the bad debt expenses were flat on a 12% increase in the accounts receivable balance, so we are seeing that portfolio behave very strongly. We are seeing good performance out of our consumers and there are no warning clouds that we would call out.

Bill Armstrong - *CL King - Analyst*

Okay, great. Thanks a lot.

Operator

Jeff Stein, Northcoast Research.

Jeff Stein - *Northcoast Research - Analyst*

My question on the outlet store economics, how do they compare relative to in mall? And wondering how the leases look relative to what you would normally sign in a factory outlet center?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

One of the reasons we were able to -- and be very pleased with this acquisition is that when going through the lease portfolio, we found that the lease portfolio was very similar to our own and we were very familiar with all of these locations and had done extensive -- were able to very rapidly do extensive real estate due diligence and we are very satisfied with the stores, the average size the store which range around 1500 square feet, they are actually perfect for our execution of our brand. And that's one of the reasons we executed the acquisition in totality.

So very similar, good leases, good structures, everything very similar. I'm sorry your second question was --?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

It was on productivity and we haven't really broken out the productivity difference between mall and outlets but we're very pleased with the productivity we have in the outlets and as Ron alluded to a few moments ago, our productivity you can assume that it's higher than what you have seen quoted out there for some of the other brands that we are mentioning.

Jeff Stein - *Northcoast Research - Analyst*

(multiple speakers) store economics -- return on invested capital?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

In the interest of fairness I'll just say that of our average Kay stores, $2 million, our average outlet store is slightly less than $2 million. It's not -- it ranges between the numbers for Zales and the numbers that were quoted for our overall average fleet. So it runs between.

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Jeff Stein - *Northcoast Research - Analyst*

Got it and I would assume that meant your return on capital would be better in the outlets that your rent structure would be lower.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

That is correct. Our rent structure is a little over. Our return on capital is as good as -- at a minimum as good as and in many cases higher than.

Jeff Stein - *Northcoast Research - Analyst*

Okay, and Ron, on the watch event, can you tell us what the impact of the watch event had on your gross margin for third quarter?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Specifically no. But I would tell you it was very helpful in driving the 90 basis point improvement in gross margin in the US division and gross merchandise margin that we experienced in the United States division but I don't have those numbers specifically.

Jeff Stein - *Northcoast Research - Analyst*

Okay, would you have had an improvement in your merchandise margin without -- if you exclude the watch event?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

I believe there would have been a slight increase in gross margin without the watch event but certainly the watch event contributed a great deal.

Jeff Stein - *Northcoast Research - Analyst*

Okay, and then final question, can you talk a little bit about AUR versus traffic in each of your brands in the US versus prior year?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

I can briefly. I'll tell you that transactions in both Kay and Jared were up and that was a primary driver of comp actually was transactions this year. In the UK, we were somewhat mixed. H.Samuel was down in terms of number of transactions. Ernest Jones was up slightly.

Jeff Stein - *Northcoast Research - Analyst*

Okay, thank you very much.

Operator

(Operator Instructions). Jessica Schoen, Barclays.

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Jessica Schoen - *Barclays Capital - Analyst*

Good morning. It sounds like you had another good quarter in the online business and I was wondering if you could tell us if you see a major difference in the mix of categories online than you see in the stores?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

Yes, there's a little bit of a difference. You are going to have more of the gift giving type purchasing online than you would have from a bridal mix, so to speak. Obviously that's something that people primarily like to go into the store, have the experience, maybe have family with them, etc.

So I would say it's a little bit more of a gift giving type mix online but yes, the business has been very, very strong. We are very happy with the direction it's going. The improvements that we've made in our websites and our mobile technology have just been fantastic for the Company and we are looking forward to continuing to drive that business.

Jessica Schoen - *Barclays Capital - Analyst*

Okay, then on your outlook strategy with the new acquisition, have you given any kind of indication as to how the outlets will play into your long-term store expansion strategy?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

Well, we think it's an important channel for us and as I said, we intend to be the leader in all channels. That's our goal and we have been the leader in the mall and we think the outlet mall business -- we know it's a very strong and good business model and so we just want to be a leader in that.

That's one of the areas that with so little development going on with the landlords out there, if they have been developing anywhere, it's been in the outlet part of the business, so that's been a strong and growing part of the overall business and we want to participate in that and be a leader.

Jessica Schoen - *Barclays Capital - Analyst*

Great, thank you so much for taking my questions.

Operator

Anthony Lebiedzinski, Sidoti & Company.

Anthony Lebiedzinski - *Sidoti & Co. - Analyst*

Good morning. First I wanted to follow up on an earlier question. I think, Ron, you had said that you expect the merchandise margin to be up in the fourth quarter. I just wanted to clarify whether that's just for the US business or do you expect potentially some (multiple speakers)?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

It is primarily the US business and I would just say and I added the words I expect them to be up slightly.

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Anthony Lebiedzinski - *Sidoti & Co. - Analyst*

Okay, within the UK in your press release, you cited the benefit of negotiated rent reductions. Now are you done with that process of renegotiating rents or do you still expect that to continue and could that be beneficial to future quarters?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

No, we are not done with that activity. I would expect that to be ongoing for potentially many years. That is a very important part of our strategy. We've said that real estate rationalization in the UK is a very important part of our goal to return that business to double-digit operating margins. So we have seen some good progress thus far but it is not over by any stretch of the imagination and something we will be focusing on for a multiyear period.

Anthony Lebiedzinski - *Sidoti & Co. - Analyst*

Okay, thank you. Also as far as CapEx, any early read for the next fiscal year where could that trend?

Mike Barnes - *Signet Jewelers Ltd. - CEO*

I think we would rather defer that. We will probably speak to you about that more when we get to the RCR conferences in January. We are taking a look through it all. We have laid out that we would expect it to open around 70 new stores I believe was the range in our IR day. We are still I think pretty much on that goal but we are going to take a look at that, take a look at our whole budget process and I'd really rather give you more detail about that I think be more accurate about it in January.

Anthony Lebiedzinski - *Sidoti & Co. - Analyst*

Okay. And lastly, just a quick housekeeping question. What is your share plan assumption for the fourth quarter?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

It will be approximately the same as this quarter so it's around 81 million shares.

Anthony Lebiedzinski - *Sidoti & Co. - Analyst*

All right, thank you very much.

Operator

Rob Whitehead, Deutsche Bank.

Rod Whitehead - *Deutsche Bank - Analyst*

Congratulations on another good quarter. A couple of things. Firstly with Ultra, how many of the stores are in outlet malls where you already have a Kay store and are they likely to stay open or not?

Secondly, in Q2 you called out the weak performance of charm bracelets particularly -- well at Jared being a drag on Jared's performance. Jared, if you exclude the Rolex thing has improved from 2.5% comps in Q2 to 5.5% in Q3. Is that because Pandora is performing better or something else?

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Mike Barnes - *Signet Jewelers Ltd. - CEO*

On the first question, Rod, about 30 of the stores we would have Kay stores in as well because we still have stores we are opening. Ron mentioned earlier that we had about 26 but I think we're going to finish the year at about 31, something like that. So it's about 30 overlap and we would operate those as Ultra just like we operate the other regional brands that we have that overlap with Kay in the malls.

We would closely monitor the productivity and the performance of those stores and make decisions about them as we would any of the stores in our fleet, quite frankly.

As far as Jared goes, yes, we were pretty pleased with the performance that we saw in Jared. When you back out the watch promotion, we did see some bead improvement in Jared as well. Pandora did show some quarter-to-quarter improvement, so we are pretty pleased with the way things are going right now.

Rod Whitehead - *Deutsche Bank - Analyst*

Thank you, perfect. Thank you.

Operator

(Operator Instructions).

Ron Ristau - *Signet Jewelers Ltd. - CFO*

If there were no more questions.

Operator

There are no questions at this time.

Mike Barnes - *Signet Jewelers Ltd. - CEO*

Okay. Thank you, operator. Just to remind everyone, our next scheduled call is on January 8 when we're going to review our holiday sales performance. We look forward to speaking with you at that point in time so thanks to all of you, goodbye and I hope you have a great day and everyone have a great Thanksgiving holiday. Thank you.

Operator

This will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

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