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SIG - Signet Jewelers Fiscal 2013 Q4 and Full Year Results Conference Call

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OVERVIEW:

Co. reported FY13 fully diluted EPS of $4.35. 4Q13 total sales were $1,513.3m, operating income was $267.7m and fully diluted EPS was $2.12. Expects 1Q14 diluted EPS to be $1.07-1.12.

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PRESENTATION

Operator

Welcome to the Signet Jewelers fiscal 2013 fourth-quarter and full-year results conference call. My name is Lorraine and I will be your operator for today's call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session. I would now like to turn the call over to Mr. James Grant, Vice President of Investor Relations. Sir, you may begin.

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

Good morning and welcome to our fiscal 2013 earnings call. On our call today are Mike Barnes, CEO, and Ron Ristau, CFO. The presentation deck we will be referencing is available from the financial section of our website, 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 filed with the SEC today. 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 & Director*

Thank you, James, and good morning, everyone. We are very pleased with our record fourth-quarter and full-year results. For the quarter our comps at Signet increased by 3.5%, US division comps grew at 4.9% on top of an 8.3% increase in Q4 the prior year. UK comps declined 1.9%, that was against a 1.7% increase in the Q4 of the prior year. I will speak in a few minutes about how we are addressing the UK results.

Signet delivered record Q4 profits driven by the strong execution of our strategies which lead to growth in same-store sales, store productivity and gross margin. Operating income was $267.7 million, up $23.8 million or 9.8%, and diluted earnings per share were $2.12, up $0.33 or 18.4%.

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Now I'll turn to the excellent results of our full fiscal year 2013. Same-store sales increased by 3.3%. The US, which represented 82% of our sales for the year, delivered 4% comp store sales which was outstanding after an increase of 11.1% last year. In the UK we comped slightly positive at 0.3%.

We delivered record profit for the year. Our operating income climbed by 10.5% and diluted earnings per share came in at $4.35, up 16.6%. There were other highlights as well beyond just the income statement. We repurchased 7.4% of our outstanding shares in fiscal 2013. Also we increased our dividend in the first quarter by 20%. And I'm very happy to say we announced today another dividend increase, this time by 25% or $0.03 per share on a quarterly basis.

Also during fiscal 2013 we had a strong operational performance. We increased our square footage globally by 8.2%, in part through the acquisition of Ultra Stores to gain a leading position in the outlet channel space, and organically by opening 46 new Kay and seven new Jared stores for a total of 53.

Now looking at the annual US performance in a little more detail. In general for the year we saw broad-based strength across many merchandise categories in both Kay and Jared, as well as the Ultra acquisition which occurred in the beginning of Q4.

US total sales were approximately $3.3 billion, up $239.8 million or an increase of 7.9%. Kay comp sales grew 6.4% which was over the 11.8% growth achieved in fiscal 2012. Jared comp store sales were up 1.6% for the year following an increase of 12.1% last year.

Fiscal 2013 Jared comps were adversely impacted by 3.5% due to the one-time Rolex clearance event in fiscal 2012 and the discontinuation of that watch line. The event's impact created a decline in average merchandise transaction value for fiscal 2013 as well, but importantly the number of transactions at Jared increased by 5.7%. Overall US same-store sales increased 4% in fiscal 2013 compared to 11.1% last year.

Finally, the record Signet operating profit I mentioned moments ago was driven by the US which delivered nearly 15% growth and a 16.7% operating margin. It was a great year for our US team members.

Now let's take a look at what drove the performance starting with merchandise. Our merchandise sales growth was broad-based with strong growth across many categories including bridal and fashion jewelry which includes colored diamonds and watches as well.

In fiscal 2013 branded, differentiated and exclusive merchandise gained relative share within our product portfolio; the category grew by 9.7% and ended the year accounting for 27.4% of our merchandise sales mix up by 110 basis points. This growth was led by Le Vian, Neil Lane Design, Neil Lane Bridal, Tolkowsky, Shades of Wonder and Open Hearts by Jane Seymour.

Other significant drivers were colored diamonds, particularly our Artistry and Vivid diamond collections as well as earrings and necklaces. Our watch business, excluding the impact of the Rolex discontinuation in fiscal 2012, was up by double-digits as we continue to develop this important category.

Our leadership in marketing and advertising continues to be an important driver of our US sales. Everyone knows that "Every Kiss Begins With Kay" and "He Went to Jared." For the holiday season we invested in eight new creative TV ads to continue our industry-leading share of voice. In fiscal 2013 our advertising investment was $224 million driven by Kay and Jared which have the scale and profitability to invest significantly.

Our branded, differentiated and exclusive merchandise continue to provide compelling stories that we can effectively communicate in our messaging. Now that drives purchase intent. We are also investing aggressively in growing our in-store technology, eCommerce and social media to build upon our multi-channel offering.

Kay and Jared stores went through their first holiday season in fiscal 2013 that they were armed with computer assisted selling tablets. These touchscreen devices were seen by both our associates and our customers as highly successful selling tools.

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In social media we remain pleased with our customers' response to the content we are delivering. Our fan base and followers continue to climb and social media outlets are driving more traffic to our stores and our eCommerce sites. We will continue providing customers who visit our digital environment with an outstanding shopping experience.

For Kay and Jared we operated newly relaunched websites as well as new mobile apps. For the year eCommerce sales grew by 48% in the US to $101.4 million.

Another very important element of our multi-channel offering has been our expansion in the outlet channel with the acquisition of Ultra Stores last year. We launched this initiative with the goal of becoming the number one jeweler in outlet malls. Our strategy is to leverage the Kay brand with Ultra's outlet expertise.

We will convert to the majority of the stores to Kay outlets by the end of the second quarter giving us the ability to leverage advertising, increase productivity and drive sales. The integration is progressing on track and our teams are doing an excellent job with the integration process. We remain very excited about this business and expect significant growth.

Now in turning to the UK -- fiscal 2013 total sales were $709.5 million, down $5.6 million or 0.8%, but same-store sales increased by 0.3%. ECommerce sales were $28.4 million which was up $4.6 million or a strong 19.3%. The UK experienced sales growth primarily in branded fashion and bridal jewelry as well as fashion and prestige watches. Sales were unfavorable in non-branded jewelry and beads.

The economic environment remained challenging and customer traffic was lower particularly in the fourth quarter. In addition, customers continue to gravitate to promotional merchandise which reduces the effectiveness of price increases and gross margin.

Store closures and foreign currency fluctuations were also unfavorable to sales. Operating income was $40 million, down $16.1 million from the last year. Operating margin decreased by 220 basis points to 5.6% compared to 7.8% last year. This was primarily due to lower gross margin. I would like to thank our UK team members though for their strong efforts in what continues to be a very challenging marketplace.

In our review of the UK business for the fourth quarter and last year it reaffirmed our commitment to our three-part long-term strategy which is focused on merchandise, real estate channel optimization and cost control.

In our review we realized that there are opportunities to further strengthen our merchandise offerings by testing and implementing improved bead programs, refocusing our merchandise efforts in general on continued innovation with a focus on our opening price point offerings as well, and by building off strength in prestige and fashion watches to enhance the future business.

We will stay focused on the merchandise assortment. We believe we have the right programs in place to achieve our targeted real estate and cost saving initiatives as well, therefore we will maintain our commitment in these areas. This market does remain challenging and, while we continue to have an achievement of 10% operating margin as our goal, it may take a little longer to achieve than originally thought.

Our goal continues to be an enhancement of Signet's market leading position. We intend to achieve that through initiatives around people by focusing on attracting, retaining and training the best team members in the industry, brands and the overall strength of our merchandise offerings, our channels of distribution of our infrastructure and our strong financial position. And now I'd like to turn the call over to Ron for a little bit more color.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Thank you, Mike. I want to start by reminding everyone that Signet follows the retail reporting calendar which included an extra week in the fourth quarter and fiscal 2013. The additional week added $56.4 million in sales and reduced diluted earnings per share by $0.02 for both the quarter and year. The extra week is not included in same-store sales calculations.

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For the quarter total sales for Signet increased 11.8% to $1,513.3 million compared to $1,333.8 million last year. Total Signet same-store sales increased 3.5% on top of the 6.9% growth last year. In the US total sales increased 14.2% to $1,244.9 million including a same-store sales increase of 4.9%. This was on top of an 8.3% comp increase last year. Non-same-store sales were up 5.3%, which includes new stores at 1.3% and Ultra which added 4%. The extra week added another 4% or $43.5 million.

I would like to point out that in our 10-K, which was filed today, we are introducing reporting on average merchandise transaction value and a number of merchandise transactions as we committed to you last year. In the US the number of merchandise transactions increased 6.4% and the average merchandise transaction value increased by 2.7%. In the UK total sales increased 1.8% to $268.4 million while comps sales decreased 1.9% as compared to an increase of 1.7% last year.

Let me walk you through this. In the UK we experienced negative comparable store sales of 1.9% and a 3.6% decline in non-same-store sales due to store closures. Offsetting this there was a 4.8% or $12.9 million increase in sales for the 14th week and a 2.5% increase in sales from currency movements. The average merchandise transaction value was down 2.4% while the number of merchandise transactions was essentially flat as increases in conversion helped to offset customer traffic declines.

Signet's eCommerce sales were $63.9 million, up $20.4 million or 47% continuing their strong trend. And for the year eCommerce sales were $129.8 million, up $37.5 million or 40.6%.

Now let's take a look at the rest of the fourth quarter P&L. Fourth-quarter operating income increased $23.8 million to $267.7 million, up 9.8%. Gross margin was $637.1 million, an increase of $73.9 million. The gross margin rate was 42.1%, up 50 basis points.

Gross margin dollars in the US increased by $79 million reflecting primarily increased sales and a gross margin rate increase of 120 basis points primarily due to an increase in the gross merchandise margin rate of approximately 140 basis points primarily caused by product mix.

Gross margin dollars in the UK declined $5.1 million primarily reflecting a decline in the gross margin rate of 260 basis points. This was primarily caused by a decline in the gross merchandise margin rate of 60 basis points caused mainly by customers' preferences for promotional merchandise with unfavorable leverage on cost due to the 14th week and currency movements accounting for the difference.

Selling, general and administrative expenses were $410.9 million and, as a percentage of sales, increased 130 basis points to $27.1 million. This was primarily due to an increase in advertising cost and store expenses due to the 14th week in the Ultra acquisition which I will discuss in more detail in a moment.

Our other operating income was $41.5 million, up $12 million versus last year due to a permanent adjustment in the credit cycle processing, the mix of finance programs selected by customers and greater interest earned from higher receivable balances. Overall the operating income increase led to a fully diluted share -- earnings per share of $2.12, up 18.4%, a very strong performance.

Now a few points on SG&A. Our SG&A increased more than usual in the quarter both on an absolute level and as a percentage of sales, but there were very logical reasons for it. First, the impact of the 14th week generated $26.7 million of incremental SG&A expense. This was primarily due to store payroll and the timing of the key Valentine's Day marketing campaign. The SG&A rate for this week was of course distorted.

Second, the Ultra impact was $13.4 million. We incurred expenses for approximately 110 more retail stores versus prior year in the fourth quarter. And lastly, a variety of items totaling $22 million which primarily reflected investment in advertising and a number of other initiatives. We believe our SG&A remains well-controlled and point out that the SG&A rate, excluding the 14th week and Ultra, would have been 26.2% of similarly adjusted sales for the fourth quarter.

As we've addressed the quarter here are a few points on the year. Fiscal 2013 was a record year for Signet; I'd like to highlight several key financial accomplishments. Total sales increased 6.2% driven by the US performance and the acquisition of Ultra to expand our outlet presence. Same-store sales were up 3.3% on top of a 9% comp last year. We improved our gross margin to 38.6% of sales, an increase of 30 basis points, driven by the strong performance of the US division.

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SG&A remains well-controlled and was reported at 28.6% versus 28.2% last year. The increase of 40 basis points was primarily due to the 53rd week and the Ultra acquisition. Excluding these items and the related sales the rate was 28.3% of sales, virtually consistent with last year. Our operating margin was 14.1% versus 13.5% last year as we continue to make progress towards our long-term goal of 15%. And finally, adjusted -- I'm sorry, fully diluted earnings per share grew by 16.6% to $4.35.

Taking a quick look at our cash positions, we began the fiscal 2013 with $486.8 million in cash. During the course of the year net cash provided by operating activities was a source of $312.7 million. Our first priority in using cash is to invest back in our own business. To that end capital spending totaled $134.2 million driven by new stores, remodeling and information technology investments.

We also invested in the long-term growth of Signet by purchasing Ultra for $56.7 million using our available cash to quickly close. Beyond re-investing in our operations we have taken a shareholder friendly view towards the use of cash.

In fiscal 2013 we returned value to shareholders in the form of both stock buybacks and dividends paid which together totaled $325.6 million. We ended the year with cash of $301 million or 7.6% of sales, consistent with our objectives of targeting cash between 7% to 9% of sales at year end.

Our net inventory ended the year at approximately $1.4 billion, an increase of 7.1% from one year ago. One of the main drivers was the addition of $40 million of Ultra inventory. Excluding Ultra our inventory increased by 4.1%.

The balance of the increase was a result of higher commodity costs and strategic investments such as our rough diamond sourcing initiative which added approximately $35 million to inventory. These increases were partially offset by actions to improve inventory turns and we believe our inventory remains the best controlled in the jewelry industry.

Let's review the performance of the credit portfolio for the year. The performance during fiscal 2013 of the credit portfolio has been very strong. Accounts receivable at year end were $1.2 billion, up 10.8% due to higher credit sales driven principally by an increase in our bridal business.

Credit participation as a percentage of US sales was up 80 basis points in fiscal 2013 to 56.9% and the average outstanding account balance was up 3.9% to $1,110. The average monthly collection rate was 12.4% as compared to 12.7% last year reflecting a mix change in the finance programs selected by customers.

As a percentage of US sales the net bad debt increased 30 basis points to 3.7%; this was driven primarily by the one-time impact of the credit cycle processing change. Excluding this impact the rate was virtually flat to last year. Please note we did reserve $2 million for the impact of Superstorm Sandy on our customers as we closed the year.

Finally, other operating income increased due to a change in the mix of finance programs selected by customers and interest income earned from higher outstanding receivable balances. This offset the increase in bad debt expense with the net benefit being approximately $15.6 million for the year between the two.

Lastly, our guidance for the first quarter of fiscal 2014 is for same-store sales growth of 5% to 7%. We're also forecasting that Q1 fiscal 2014 diluted earnings per share will range from $1.07 to $1.12. Our capital spending for fiscal 2014 is anticipated to be $180 million to $195 million, which includes opening 65 to 75 new Kay and Jared stores, remodels, the Ultra integration and investment in information technology as we continue to focus on growth and productivity.

At a high level, our financial objectives for the business in fiscal 2014 are to increase sales and gain profitable market share, to manage our gross margin by increasing sales productivity and balancing commodity cost increases with price adjustments, and developing unique multi-channel advertising programs and supporting new initiatives while appropriately managing our SG&A ratio. We believe we are well positioned for another strong year of accomplishment and now I will turn the call back over to Mike.

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Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

Thanks, Ron. In conclusion, I would like to once again thank the Signet team worldwide for their contributions to what has been a very successful year. We would now be pleased to take any questions that you might have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Simeon Siegel, JPMorgan.

Simeon Siegel - *JPMorgan - Analyst*

Congrats on the year. So, Ron, just given the timing shifts ahead related to the 53rd week, what is the right implied total sales range for the first quarter within that 5% to 7% comp?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

I'm sorry; we didn't give a total sales rate, so I can't give it since we didn't put it in the press release. It will be 5% to 7% comp. I will point out that we do have this calendar shift of Mother's Day coming back into the first quarter. That does not affect comp because of the way that comp calculations shift with the 53rd week. So I just want to make that point. But the comp performance we are expecting is driven by the underlying performance of our business.

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

Yes, Simeon, this is Mike. Just to add to that, it really -- I think the right way to look at it is that the broad based core business is really driving the underlying comp performance. And the couple of shifts that we've had like with the 53rd week or with the Mother's Day really aren't what is driving that underlying comp.

Simeon Siegel - *JPMorgan - Analyst*

Got it. And then, Mike, could you just talk briefly about the low hanging fruit at Ultra? I mean is it as simple as just converting the signage out front and then letting the Kay brand do the rest? I guess you guys are planning to convert by the middle of the year. I mean, should we see accretion any earlier than that Q4 date?

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

No, you know, it's not quite that simple. I wish that it were that simple. But there are a lot of things -- what we are doing is we really are marrying the leverage and the equity that we have with the Kay brand name along with the expertise that Ultra has. They had over 100 outlet stores when we made this acquisition, which basically tripled the number of stores that we had more or less.

And so immediately it put us in a leadership position within the outlet store business. But they also brought a lot of expertise on running outlet stores and good ideas can come from anywhere. We are very pleased with a lot of what we have learned as we have been transitioning the Ultra stores. And we believe we're going to be well-positioned.

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Having said all that, with the equity that Kay brings, as we change the name plates on the stores, as we update the merchandise mix, for instance, we were able to get some Jane Seymour product into the Ultra stores in time for Valentine's Day and it was a great seller in those stores even without the Kay nameplate.

So I think the change in merchandise mix, the equity the Kay name brings and the expertise that Ultra brings in the outlet store channel, that's a strong combination that is really going to help us drive that business higher and higher over time.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

And just to follow up on your point on accretion on Ultra, again we are not expecting -- it will actually be slightly dilutive in the first and second quarter, as we've said repeatedly. So it is a couple of Penney's each quarter, and probably relatively flat, maybe a penny in the third and then we're expecting it to start to become accretive in the fourth quarter as we complete the program.

Simeon Siegel - *JPMorgan - Analyst*

Great, thanks a lot, guys. Good luck.

Operator

Lorraine Hutchinson, Bank of America.

Lorraine Hutchinson - *BofA Merrill Lynch - Analyst*

As we think about gross margin for this year and next can you just provide an update on product costs and where those are versus last year?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Well, it's a very complex question. As you know, our product costs are really long-term averaging costs. We are running a FIFO inventory system, but it averages the cost of inventory over time so that any movement in the commodity prices, weather up or down, is slowly reflected in the average cost as it moves through the system.

So it's hard for me to predict exactly where costs will go in the future. You know what's been happening with gold, we actually got a little break on gold this year, but diamonds we expect to start to accelerate again due to the pressures on demand really.

So what I would say to you is that whatever happens in costs as we move forward, our goal is to manage our gross merchandise margins by balancing cost increases with whatever price increases we need to take. And it's hard to be more specific than that because I don't how to predict costs going forward. So we are always looking at it and making adjustments as we need. I'm sorry I can't be more specific about that.

Lorraine Hutchinson - *BofA Merrill Lynch - Analyst*

And have you raised prices so far this year?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

We usually raise prices -- not so far, but we usually do a price increase somewhere between the first and second quarter of the year. That has been our historical trend, so we intend to do that once again, that is correct.

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Lorraine Hutchinson - *BofA Merrill Lynch - Analyst*

Great, thank you.

Operator

Jeff Stein, Northcoast Research.

Jeff Stein - *Northcoast Research - Analyst*

A couple questions. First of all, Ron, wondering if you could talk about the impact of the Mother's Day shift in terms of what it is worth to the first quarter. And in turn obviously I guess it will have a negative impact on Q2?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

It's an interesting question. Thank you for the question. When Mother's Day shift into the first quarter this year it has virtually no impact on the comp calculation because the way in which you shift the comp calculation resulting from the 53rd week. So it has no impact on comp. It will have an impact on total sales in the range of -- I would say in the range of $30 million, okay. And that will come out of the second quarter and move into the first quarter.

What will happen is, and this is why we indicated in the 8-K that we filed right before we went to the ICR conference, is that what that will do is in the second quarter it will make it difficult for us to generate significant increases in earnings per share because of the dollar shift back into the first quarter.

Therefore we have made the statement we believe that it will be essentially flat-ish in the second quarter for that reason, then with of course growth resuming as we move into the third and fourth quarter. So that is really what is going to happen as a result of it. Again, it doesn't affect comp; it just simply affects dollars in the first quarter.

Jeff Stein - *Northcoast Research - Analyst*

Understand. And regarding your -- kind of your march towards the target of a mid-teens EBIT margin, I'm kind of curious -- given the fact that you are investing this year in Ultra, do you believe that you can improve over your 14.1% EBIT margin that you just reported for the fiscal 2013 year?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

We certainly believe that that is an objective of the Company.

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

And as we stated --

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Yes, sir.

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Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

-- we feel pretty good about achieving the objectives that we have laid out at this point in time.

Jeff Stein - *Northcoast Research - Analyst*

Okay and then final question. If you could just address kind of your thinking on the UK in terms of pushing back your target to achieve that 10% EBIT. Is it primarily a macro headwind or are there any structural issues such as perhaps not being able to close as many of the unprofitable stores as soon as you would like? And maybe you could just talk about the plans for store closings this year in the UK?

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

I will address that at a high level. Basically certainly we continue to see strong macro headwinds there. I will just reiterate within the presentation, but just make sure everybody has this, basically especially in the fourth quarter we saw a decline in traffic, we had great execution in the stores and our conversion was up, so that kind of offset the track that could put us back to even.

And the downside that we had there was really on the average selling value of the merchandise because the customers just continue to be strongly promotional in their choices. So that is really what drove what happened in the UK.

We still believe very strongly in that three-part strategy. We are working on merchandise fast and furious right now; we will continue to do that. We believe that we have done some very good analysis of our real estate portfolio and we do continue to close doors as appropriate based upon the financial analysis that makes sense to do so.

So we haven't really slowed anything down there. And we are making the expected gains that we expected on the cost control initiatives as well. So I believe that operationally we have been pretty much on target. The fourth quarter was a downward shift in traffic and downward shift in the average selling prices of the merchandise based on promotions that was just too much to overcome even with our increased conversion process.

So it is going a little bit slower, but we still believe in our strategy there. The team is working very hard to implement it and execute it and we are confident that we will continue to move towards our goals.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

And just to be specific on your question on store closures -- it will be around about the mid-20s of stores that are closed next year in the UK.

Jeff Stein - *Northcoast Research - Analyst*

Thanks, Ron.

Operator

Rick Patel, [Stephens].

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Rick Patel - *Stephens, Inc. - Analyst*

Congratulations on a nice year. Can you give us a little bit more detail on the benefit you had, the US gross margins from merchandising mix? I'm curious if fashion jewelry did better than bridal or if there is something else going on there. And should we expect that benefit from mix shift to continue for the rest of this year?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Well, I would say that the bridal business was good, the fashion business was good, the colored diamond business was good, the watch business was pretty good. We saw growth around -- the shift is kind of subtle in the mix. It's nothing that is -- like there is one thing that I would just call out and say, wow, that is what caused the mix shift.

We do have a slight mix shift relative to having the bridal business up and some of the Neil Lane products and some of the more expensive products in the line. But it is really -- it's kind of an overall mix rather than one specific thing that caused it.

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

Yes, I think it's pretty subtle really, Rick. But, as we said, our branded, differentiated and exclusive merchandise grew by 9.7% last year and that certainly -- as we have stated, it has a slightly higher margin. But again, it is pretty subtle; it is not an extremely higher margin on a comparative basis. But when you add it all together that is where it came out in the mix. I would expect to continue to see brands do well as we move forward.

Rick Patel - *Stephens, Inc. - Analyst*

And then just a question on eCommerce. In the past you have talked about consumers preferring to shop in person for jewelry instead of going online so that they can experience the product. And at the same time your eCommerce sales have been very strong over the last year.

So do you think customers are changing their approach to buying jewelry more towards online channels? Or do you see your strong growth as a function of taking market share? Just help us think about that.

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

You know, it may be a little bit of both, quite frankly. One of the strongest initiatives that Ron and I have been driving the last couple years is eCommerce. And when you look at the growth, the long-term growth that we have had there, it's pretty astounding. In the US we grew eCommerce by 48% and even in the UK, which, as we have just talked about, a very, very difficult market, we had strong double-digit growth there as well.

So we are behind so many initiatives here and we believe in not only eCommerce but the entire digital ecosystem. It's everything that we are doing out there with our customer, information base, with the social media initiatives that we have tackled and that we continue to move forward on that people are very pleased with, as well as the eCommerce sales. And we are seeing the benefit online and in-store and the technology that we have in store is just making that even stronger.

These touchpads that we supply to our associates with during the fourth quarter, during -- the first time they have them during the holiday season, it was very well received and we got lots of great feedback from that. So I believe everything we are doing from a digital standpoint will continue to drive forward and we can expect to see continued gains in that area.

Rick Patel - *Stephens, Inc. - Analyst*

Thank you very much.

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Operator

Oliver Chen, Citigroup.

Oliver Chen - *Citi Research - Analyst*

Congratulations on a great year and a solid quarter. Regarding the 5% to 7% comp guidance, is that going to be primarily driven by transactions? How should we think about the key metrics from which you will likely achieve that? And also, could you speak to the potential for bridal penetration to increase other income? And if that is something that will be a positive to the operating margin this year?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

I think -- let me answer the last question first. I think the major shift we saw last year was as a result of our customers opting out of our interest-free program and into our normal credit terms. That shift has stabilized, if you will. We are not seeing that shift move any further than what it did during last year. So that was a primary driver of the increase in other operating income. So that level of shift I do not believe you should count on for fiscal 2014 or forward.

As the credit portfolio grows, obviously, the income earned on it will increase, but that is at a much lower rate than what happened last year with the shift in program, that is number one. And your first question had -- repeat it again, transactions? It is hard to predict transactions versus price. We don't actually predict forward that way. I will have to defer an answer on that until we get through the first quarter.

We have seen very strong business, our business has been good. So I would bet that our transactions are running up as well as our prices too, I would say a little bit of both just like we got in the fourth quarter if you really push for an answer on that. I think that would probably be our expectation. But I will have to say we will have to see how it ends up.

Oliver Chen - *Citi Research - Analyst*

Thank you. And our final follow-up is in relation to the changes with Rolex, have you guys -- do you expect there to be a change in terms of what you are filling in there? And will this be a potential benefit to the back half as you anniversary with a newer department there?

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

You know, we are very pleased with the way that our watch business is building right now. As I mentioned in the prepared remarks, ex-Rolex we had strong double-digit gains in most of the brands, quite frankly. And we continue to work with new brands, we have put more fashion into there with MICHELE Watches, for instance, we have been testing Gucci, we have some other things up our sleeve.

But we feel very good about the growth of our watch business and while it is a small mix in the United States, it is much more prominent in the UK. It has been a strong business -- a stronger part of our business in the UK as well. So we think the watch category is extremely important to our future and we are working diligently to continue to build it strongly. So I would just say stay tuned, Oliver, because there is a lot of good things to come there.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

And, Oliver, just to follow up on that just a little bit. Again I would say that as we look across the year we, given our guidance for the first quarter, we've suggested that people be very careful about their expectations for the second quarter because of the Mother's Day shift.

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But as we move into the third and fourth quarter where we are not up against the Rolex and so on the business should get better. And I think you will see more EPS growth in the second half than you will in the first half, barring what happens in the first quarter.

Oliver Chen - *Citi Research - Analyst*

Thank you. Best regards.

Operator

Jennifer Davis, Lazard Capital.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Let me add my congratulations on a great year and what sounds to be like a very strong start to the first quarter. A couple of clarifications. So, should we assume, based on the 5% to 7% comp guidance, that Valentine's Day comps were kind of in that -- or at least February comps were kind of in that range?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Well, we generally don't comment on individual months as you indicate, but our Valentine's Day business was good. And we were, as Mike indicated, pleased with the way it all turned out. We had experienced a small impact from the snowstorm; we lost about maybe $5 million in sales for that snowstorm that happened on a Saturday. Other than that our Valentine business was good.

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

I think one way that you could characterize that, Jennifer, is to think of it very broad-based both over time and over product categories. I am pleased to say, again, that our business has not been in any type of a one trick pony, whether it be in a short time period or a narrow category it has been very broad-based for the quarter to date and over the categories.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Yes, no, absolutely. I mean your --.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

February was a strong month; it was just a strong month for us.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Okay, great. And then going back to the second quarter, I missed this, Ron. You said something about flattish. Were you referring to operating margins or to EPS?

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Ron Ristau - *Signet Jewelers Ltd. - CFO*

I was referring to EPS really, I was trying to -- taking a look at how we think the pattern of the year will develop. And I would point out that even though it doesn't affect comp, there is a dollar shift as a profit shift associated with that Mother's Day thing.

And therefore, since Mother's Day is such a big part of the second quarter, it will be more difficult for us to show real earnings per share growth that quarter. And then as we move into the third and fourth quarter things should be back on track.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Right, got it, okay. And then, so obviously second-quarter consensus estimates need to come down. I know you don't provide full-year guidance, but could you comment maybe on your comfort level with full-year consensus estimates? Because it sounds like there is possibly upside to consensus estimates in the back half.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

I wish I could.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Okay.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

I really can't do that. But you have to think about what we have said and make your own inferences.

Jennifer Davis - *Lazard Capital Markets - Analyst*

All right, fair enough. Okay, and then my question is on the merchandise at Ultra versus Kay outlets. I mean the merchandise is pretty significantly different. I know you have added some brands like Jane Seymour to Ultra now, but -- I guess it is still early, but you have got your rates from holiday. How are you thinking about maybe some of the merchandise from Ultra going in to Kay outlets, kind of the mix that you have got there?

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

That is a great question because really what we are trying to do is take an analysis of -- obviously we know how the Kay merchandise performs and we have been analyzing how the Ultra merchandise performs. I think I said it earlier, but good ideas can come from anywhere. And so, if they have got some great merchandise that we think could be a big benefit for our outlets in general we will put them in all the outlet stores.

And we have learned a lot during the transition of Ultra. And we realize that there are certain specifics in running outlet businesses that are different than running a full priced mall store or a full priced off mall store. And so, we need to really tweak our outlet business model anyway and we think it is just going to make our business even stronger.

I mean we have had a good strong outlet business even with the limited number of doors we had until the acquisition. We believe that we will be able to drive a lot of that productivity as we convert the Ultra stores into Kay. And we believe the learnings within the process will lead us to enhance our outlet merchandise offerings and see even more improvement out of that. So it is really a win, win, win situation the way we view it.

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Jennifer Davis - *Lazard Capital Markets - Analyst*

Yes, yes, I agree with that. I think that you can take some of the Ultra merchandise or the learnings from Ultra Stores and apply it to the Kay outlets. And then finally, how are you thinking about the shop in shops or the Burlington Coat Factory jewelry locations?

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

Well, we are continuing to analyze that business. And right now we are still in the learning stages of operating those as we finish this transition. And we will talk about that more if we see anything change in the future.

Jennifer Davis - *Lazard Capital Markets - Analyst*

All right, great. Thanks and best of luck.

Operator

Ike Boruchow, Sterne, Agee.

Ike Boruchow - *Sterne, Agee & Leach - Analyst*

Let me add my congratulations on another great year. I guess two questions, the first one I guess for Ron. The bad debt has gone up to 3.3% from 3% last year. Ron is that just a function of the credit portfolio continuing to grow? Can you comment on your average monthly collection rates and just the health of the portfolio right now?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Sure. As I indicated, we think of the portfolio is performing very, very strongly. The bad debt expense this year in the fourth quarter was impacted by two things -- number one is this change we made in the last fourth quarter that doesn't have any real net impact across either fiscal year, but it affects the bad debt in the quarter.

So let me just give you what those numbers would be if I restate it apples-to-apples. In fiscal 2012 the bad debt expense would have been 3.6% and in fiscal 2013 it would have been 3.5%. So it's that shift that is causing the difference from on an annual basis moving from 3.4% to 3.7%, but that is just a one-time shift.

The net impact of it when you take the impact of how we move bad debt and how we moved the operating income, it moved $2 million -- one year was positive $2 million and one year was negative $2 million, the net being zero and now it is all restated and we have the right operating structure going forward. So that is what happened.

The portfolio is performing great. The change in the collection rate, which came down by 30 basis points, really had to do with the mix of programs. As the customers -- remember I said they were choosing less our interest-free program and more our regular credit terms. As they choose the regular credit terms the payment cycles stretch out a little bit further. So therefore it affected the monthly collection rate by 30 basis points, that is what caused the entire change.

So other than that we really love the way the portfolio has been performing, it has been very strongly supporting our business and, as I mentioned in particular, our bridal business. Consumers are behaving very well. And other than a small regional issue of course called by Superstorm Sandy in New York where we set up a specific reserve of $2 million, really the portfolio is performing great and we are very pleased with it and look forward to another good year this year.

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Ike Boruchow - *Sterne, Agee & Leach - Analyst*

With the participation rate approaching 57% of US sales is there a certain ceiling that you guys kind of view that and kind of say to yourselves, well if it hits X that is kind of the tipping point. We don't want to put too much of our sales on credit?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

No, I mean we really don't. We have a lot of confidence in our credit scoring mechanisms and the way we grant credit and we have seen no change in the -- for instance, still approximately 50% of the people who apply for credit are granted credit; 50% do not get credit.

So, no, there is no ceiling to it. And as we continue to focus on our bridal business you could see that number keep going up because, as I've mentioned a couple times, the penetration in bridal can be 70 or even a little bit higher than 70 some times. So that is really what drives it.

I don't think it ever gets terribly much higher than 60-ish, but I think as it moves up it doesn't really concern us, Ike, because we are watching all the credit decision metrics and those are very high quality metrics and the performance has been great.

Ike Boruchow - *Sterne, Agee & Leach - Analyst*

Okay, last -- and a follow-up is, the last couple years I think I believe you guys have provided some kind of free cash flow guidance. Just wondering if there is anything you can kind of share with us there. And also when we think about your working capital needs this year should there be a benefit because of the cost of goods flowing through on the lower cost on diamonds and some of these precious metals?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Okay, let me see if I have the question right, I'm sorry. The capital -- our capital requirements for next year?

Ike Boruchow - *Sterne, Agee & Leach - Analyst*

No, no, no, the last two years I believe you have given your free cash flow guidance for the year.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Yes, we're trying to kind of back away from free cash flow guidance, not that there is anything wrong with our cash flow; it's just that it is a non-GAAP measure and it was causing us a lot of heartache. So we decided not to do it; we are still giving the capital guidance which is in the $180 million to $195 million range.

We believe our cash flow will continue to be strong and we will be able to continue to invest in capital and dividends. And the strength of our cash flow is evidenced by the fact that we increased the dividend by 25% this year, but we're kind of trying not to give specific numbers on that.

Ike Boruchow - *Sterne, Agee & Leach - Analyst*

Well, I guess to rephrase another balance sheet question, because of the input cost deflation that should start to work its way through the P&L, could inventories start to come in below sales growth over that (multiple speakers)?

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Ron Ristau - *Signet Jewelers Ltd. - CFO*

Oh, okay, that is a good question, yes, I understand, I'm sorry. You know, I again say that the changes in commodity pricing have to take place over a long, long period of time before they start to really have a major impact. We are doing and executing certain programs one of which I called out which is our rough diamond purchase program, which does add a layer to our inventory, so it moves this impact a step in the supply-chain and that will -- we will continue forward with that.

So my overall view is that even though there could be some benefit from commodity pricing and let's all knock on wood, hope that it goes through the year, yes, the inventory would adjust a little bit. But we will be buying more and more of these rough diamonds which will have some offsetting impact. And my bet is that you would still see slow low-single-digit type growth in the inventory levels.

Ike Boruchow - *Sterne, Agee & Leach - Analyst*

Great. Good luck, guys.

Operator

Bill Armstrong, CL King & Associates.

Bill Armstrong - *CL King & Associates - Analyst*

Could you give us the expected costs of the Ultra integration for the first quarter or the first half of the year?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

What I can do is give you the total capital investment that we're going to make next year, which it's for all things. It is about -- for changing the signs and reconfiguring some stores and a variety of other work and putting new POS systems and bringing them up on our POS and credit systems, that is about $18 million. That is included within the base of our capital spending.

Within the first two quarters of the year, which include our let's call it transitional and start-up costs and overlap costs and things of that nature, we would expect it would be a couple of pennies each quarter that we actually lose in Ultra. But other than that we expect it to start becoming accretive by the fourth quarter of the year. But the main cost is that capital conversion cost and that is about $18 million.

Bill Armstrong - *CL King & Associates - Analyst*

Got it, okay. Does -- are Ultra's gross margins or merchandise margins more or less in line with the rest of the Company or is there a significant difference?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

They are more or less in line; they are a touch lower right now. As we change the mix of products, and we will see how that develops over the year, their margins are a touch lower than ours right now because of the way they discount and the way that they buy. We expect of course to drive buying efficiencies and we'll be adjusting the mix.

So outlets -- even our own outlets run just a touch lower than our business, nothing significant. But because of the fact that you've got more promotional product in there, there is usually a slight, slight impact in the margin.

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Bill Armstrong - *CL King & Associates - Analyst*

Got it, okay. And your credit card operations, are they -- is that in the Ultra Stores or if not (multiple speakers)?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

No, it's not and that is of course a big opportunity for us. We will be -- when we convert to our POS system that will automatically give the Ultra Stores access to our credit systems. So it will be mid-year before they have access to the Signet credit department. And that is when we expect that will be very helpful to sales in the second half of the year. Of course because it is something they cannot offer today.

Bill Armstrong - *CL King & Associates - Analyst*

Okay, so -- all right, so a POS rollout obviously is part of the integration. And I guess (multiple speakers).

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Yes, POS is part of the integration and POS includes the credit rollout.

Bill Armstrong - *CL King & Associates - Analyst*

Got it, okay. And when we look then at the customer finance participation of 56.9%, I guess we should exclude the Ultra sales from Q4 in the numerator?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Yes, that number is quoted I think against the sales without Ultra.

Bill Armstrong - *CL King & Associates - Analyst*

Okay, okay.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Yes.

Bill Armstrong - *CL King & Associates - Analyst*

Last question. In what way did Sandy impact bad debt? Why would a storm have impacted (multiple speakers)?

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Well, we see certain of our -- I mean customers in the New York area were terribly impacted from a personal financial situation, from -- people lost their homes, their lives were disrupted. So that is really what caused it. And so that -- we noted it and we've been trying to work as best we can with our customers and we set up this reserve because we do understand that there are extenuating circumstances.

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Bill Armstrong - *CL King & Associates - Analyst*

Understood. Okay, thank you very much.

Operator

Jessica Schoen, Barclays Capital.

Jessica Schoen - *Barclays Capital - Analyst*

Thank you for taking my question. I was wondering if there was any market share data that you could share with us to help us understand how you are growing in context of the overall market maybe even just in the US.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

In times of overall we use the government statistics which have not yet really been issued. We can give you more color on that in the future. Obviously we don't -- usually comes in that we can probably give you some numbers by the second quarter. But we believe we continue to grow market share. We just don't have the official statistics, therefore we couldn't quote it in our 10-K or in our call at this point in time. But when we get those statistics we will be happy to share them with you.

Jessica Schoen - *Barclays Capital - Analyst*

Okay, understood. And then you talked about a few merchandise categories that were very successful for you in the past year. I was wondering if looking ahead to 2013 if there are any initiatives in particular that you are very excited about?

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

Yes, I mean we always have initiatives that we are excited about. Just an anecdotal comment, our merchandising team was very excited about some of the new tests that they ran. But tests are tests so we are continuing to analyze the results of that.

We think we're going to have great merchandise offerings for the year; we think that current brands that we have and the way that we are extending those and developing new and exciting and innovative products is really going to help us continue to drive a strong business. But there will be some new stuff coming and there will be continued evolution of current brands and merchandise.

And by the way, our merchandise offerings on the branded side are fantastic and, as you heard on our exclusive and differentiated brands, they grew by 9.7%. But even in our non-branded core merchandise offerings, a lot of people don't realize a lot of that merchandise is still exclusive to us. And we put just as much effort into how we innovate it and putting fashion into it and following the trends.

So we are pretty excited about our merchandise offerings across the breadth of our Company right now. So I would say stay tuned just as last year -- I also don't like to get into too much detail for competitive reasons until we have things positioned out in our stores and we can start taking advantage of it.

Jessica Schoen - *Barclays Capital - Analyst*

Great, thanks very much.

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Operator

Thank you. And I will now turn the call back to Mr. Barnes for closing remarks.

Mike Barnes - *Signet Jewelers Ltd. - CEO & Director*

I would like to thank all of you for taking part in the call and for the great questions that you had for us. Our next scheduled call is on May 23 and we will review our first-quarter results at that time. Thanks again and good-bye, have a great day.

Ron Ristau - *Signet Jewelers Ltd. - CFO*

Thank you.

Operator

Thank you. And thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating, you may now disconnect.

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