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EDITED TRANSCRIPT

SIG - Signet Group Fiscal 2014 Q2 Results Conference Call

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OVERVIEW:

SIG reported 2Q14 total sales of $880.2m, consolidated operating income of $105.5m and fully diluted EPS of $0.84. Expects 3Q14 EPS to be $0.37-0.43.

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PRESENTATION

Operator

Welcome to the Signet Jewelers second-quarter fiscal 2014 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 will now turn the call over to Mr. James Grant, Vice President of Investor Relations. Sir, you may begin.

James Grant - *Signet Jewelers Limited - VP, IR*

Good morning and welcome to our second-quarter fiscal 2014 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 that was filed with the SEC on March 28, 2013. 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 Limited - CEO*

Thanks, James and good morning, everyone. We are very pleased with our second-quarter and first-half results and now we are focused really on our second half of the year, particularly our important fourth-quarter holiday selling season. For the first three weeks of the third quarter, we have had a positive start in both the US and the UK, which is a nice trend reversal in the UK. Keep in mind though that we are only three weeks into the quarter and we have seen a lot of noise out there in both the macro retail environment and obviously, the geopolitical scene. But we do have some major events beginning soon. In fact, this weekend, we have a major event and continuing into later September and October and we remain well-prepared for the second half, especially the Q4. I will discuss some of our strategies for holiday in just a couple of minutes.

Turning back to the second quarter, we delivered a solid financial performance in Q2 driven by the excellent execution of our strategies, which led to sales growth and earnings growth, excluding our acquisition late last year. Our second-quarter comps at Signet increased by 3.6%. The US division comps grew at a 4.9% rate on top of 8.2% last year while the UK comps declined by 2.4%. We also had tremendous continued momentum

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within our consolidated e-commerce space as we grew by 28.9%. This all led to operating income of $105.5 million and diluted earnings per share of $0.84 were at the high end of our guidance. Excluding Ultra, our diluted earnings per share were $0.90.

Let's begin by taking a look at the US division performance. The US total sales were at $741.1 million and that was up $39.2 million, or 5.6%. The US same-store sales increased by 4.9% in the second quarter. Kay comps increased a strong 5.8% while Jared increased at 5.5%. The success in both concepts was driven by particular strength in bridal, colored diamonds and watches.

Within these categories, our branded merchandise continued to do very well. Kay and Jared experienced increases in both transaction counts and also average transaction value. So it was a nice mix in the increase. And in the US, e-commerce performed very strongly with sales up $6.7 million to $25.3 million, which was an increase of 36%. The US division operating profit declined by 4.9% with a 15% operating margin. But excluding the diluted effect of the Ultra acquisition, operating income was $119.3 million and operating margin was 16.8%, up 10 basis points. It was another great quarter for the US team members.

Now let's take a look at what is really driving the business. The drivers of our performance were our sustainable competitive strengths. In particular our great customer experience, our investment in marketing and broad customer acceptance of our powerful merchandise offerings, especially our exclusive and differentiated brands. The customer experience is really central to our success and we remain focused on the training and the development of our store teams, including the best use of in-store sales enhancing technology.

Branded, differentiated and exclusive merchandise continue to perform well, particularly among some of the brands you see here listed on slide 5 like Neil Lane, Tolkowsky, LeVian, Open Hearts by Jane Seymour, etc. We also saw success across selling channels. As I mentioned, in the US e-commerce sales were up 36%. This was driven in part by 14 million visitors to our sites and the amazing thing is over 40% of those came in through mobile devices.

Now I would like to talk a little bit more about our outlet business. As most of you know, Ultra was purchased to build out an outlet strategy. Outlets are seeing stronger customer traffic and development trends than any other retail selling channel at this time. By the end of this year, we expect to be operating approximately 120 Kay outlets and 39 Ultra stores. Operationally, our strategy is working well and we are on plan. We have converted to Kay the nearly 70 stores we set out to convert from Ultra.

Our field teams are up and running and they are in training as we speak. The IT has been integrated, including our in-house credit program. Credit penetration in our converted outlets is approximately 40% and growing. Now that is up from the low 20%s as standalone Ultra stores before the acquisition. We are also transitioning the merchandise mix to leverage the Kay brands and we are creating made-for-outlet product to further differentiate from the Kay mall stores and also to meet the demands of the bargain-seeking outlet customer.

From a financial perspective, we are on plan as well. The first-half EPS dilution was $0.09 as was forecast. The third-quarter dilution should be relatively minimal and then, in Q4, we continue to expect to be accretive. So overall, we are very pleased with the initial performance of this strategy and the acquisition and we expect to see continued improvement over time from where we are today.

Now, I will turn to the UK. Total sales in the second quarter were $139.1 million, down $12.9 million, or 8.5%. Comp sales decreased by 2.4% compared to an increase of 2.1% in the second quarter last year. The total sales decline of 8.5% was due primarily to three things. The impact of closed stores was $5.6 million; the same-store sales decrease, $3.4 million; and currency fluctuation that hit us for $3.9 million. In Ernest Jones, which reported a negative 2.4% comp, the number of transactions increased driven primarily by strength in the branded bridal and watches, excluding Rolex and average transaction value was lower. And that is primarily due to the impact from Rolex being offered in fewer stores compared to the prior year.

In H.Samuel, which also reported a negative 2.4% comp, the number of transactions declined. That was due to lower traffic and store closures. This resulted in lower sales across many merchandise categories, but was partially offset by strength in branded bridal products. Sales in both of the businesses were impacted by lower bead transactions.

E-commerce sales were $5.9 million, which was up 0.3 million, or 5.4%. Our UK websites attracted 7 million visitors in the quarter and unbelievably, 45% of those came in through mobile devices. The operating loss was $0.8 million, an increase of $0.5 million from last year and that is primarily

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due to lower sales, partially offset by cost reductions. I would like to thank our UK team members for their continuing efforts to improve the business there.

So how do we win back the back half of the year? Well, we remain confident in our ability to deliver outstanding product ranges that meet our customers' desires and we have tested a lot of new programs with great results. We have exciting new products that will roll out in the second half, including our exclusive differentiated brands, some of which you see pictured here on slide 8. In bridal, we are line-extending Leo Artisan and we are also extending the very successful Neil Lane Bridal line. We will also expand colored diamonds, which have been really hot in the past year and this includes the Artistry brand at Kay and Vivid brand at Jared.

In LeVian, another hot fashion brand for us, we will roll out proven styles in new colors supported by special events. The Open Hearts New Wave collection is producing great results and we are expanding this brand as we did the Family collection last year. The initial tests indicate Wave is another big winner for the brand. We will speak more about our merchandise initiatives at our Investor Day conference on October 8 and I hope you can all make it there.

We will continue to build upon our digital ecosystem as well, launching a new e-commerce website, KayOutlet.com, in September to support our outlet strategy, as well as enhanced Kay and Jared mobile websites. These initiatives, together with a variety of other new and exciting product offerings, will, we believe, produce an exciting and successful holiday season. Our team of merchants have done a great job and they are continuing to stay at the forefront of new products and trends.

We also have new and memorable ad campaigns ready to launch for the holiday season. We are increasing our advertising investment and we will have a greater number of television impressions over holiday compared to last year, as well as a much higher digital media profile. Plus our enthusiastic and our well-trained sales teams are primed and ready to support the merchandise initiatives. With all this in place, we believe we are well-positioned for the back half of the year and as I mentioned, especially the holiday selling season. And now, I will turn the call over to Ron for more color.

Ron Ristau - *Signet Jewelers Limited - CFO*

Thanks, Mike and good morning, everyone. I will start by explaining sales in more detail. For the quarter, total sales for Signet increased 3.1% to $880.2 million compared to $853.9 million last year. Our same-store sales increased 3.6% compared to 7.1% growth last year. In the US, the total sales increased 5.6%, or $39.2 million, to $741.1 million, which included a same-store sales increase of 4.9%, as Mike discussed. Our non-same-store sales were up 0.7%, which includes a 4.2% increase for Ultra and a 3.5% decrease for the US, excluding Ultra. This is caused by the timing shift due to the 53rd week in the calendar last year. The reported number in the second quarter last year includes a $32.2 million benefit from the calendar shift of a Mother's Day promotion. The US sales increases were driven by particular strength in bridal, colored diamonds and watches and both Kay and Jared experienced increases in transaction counts of 2.2% and 1.4% respectively. In addition, Kay increased average transaction value by 4.7% and Jared by 3%.

In the UK, total sales decreased 8.5%, or $12.9 million, to $139.1 million while comp store sales decreased 2.4%. The total sales declined primarily due to the same-store sales decline of $3.4 million or 2.4%, the impact of closed stores of $5.6 million, or 3.7%, and currency fluctuations of $3.9 million, or 2.4%, which were unfavorable.

The UK, as mentioned, showed particular strength in branded bridal and watches, excluding Rolex. In our H.Samuel brand, transaction counts declined by 5.4%, but increased in average transaction value by 1.4%. And Ernest Jones experienced an increase in transaction count of 2.2% while average transaction value decreased by 8.9% primarily due to the Rolex impact. Signet e-commerce sales were $31.2 million, up $7 million, or 28.9%, continuing on their strong trend.

Now let's take a look at the components of operating income. Our gross margin was $309.7 million, a decrease of $1.5 million. The gross margin rate was 35.2%, down 120 basis points in the quarter. The inclusion of the results for Ultra increased gross margin dollars by $5.7 million. However, it reduced the consolidated gross margin rate by 50 basis points and the US gross margin rate by 70 points. The Ultra gross margin is lower than the core US business due to lower Ultra store productivity and the impact of Ultra integration expenses.

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Gross margin dollars in the US increased by $1.3 million compared to the second quarter of fiscal 2013 reflecting higher sales, offset by a gross margin decline of 180 basis points. Let's get into that. The lower US gross margin was primarily attributed to the following components. Gross merchandise margin decreased by 50 basis points, which was entirely attributed to Ultra. The core business ran even to last year. And store occupancy and operating expenses deleveraged by 70 points, of which 40 basis points was due to Ultra and the remaining 30 basis point change was the result of the impact of the year-on-year calendar shift and an increase in the number of store openings. The US net bad debt ratio increased to 4.9% of sales compared 4.5% of sales in the prior-year second quarter. The increase in the ratio was primarily due to growth in the outstanding receivable balance. I will explain further in a moment.

In the UK, gross margin dollars decreased $2.8 million primarily affecting the impact of decreased sales and currency fluctuations, offset by a gross margin rate increase of 40 basis points. Currency translation costs were $1.1 million of the decrease in gross margin. The gross margin rate increase was primarily driven by the sales mix.

Our selling, general and administrative expenses were $250.5 million and as a percentage of sales increased 40 basis points to $28.5 million, but the inclusion of the results of Ultra increased SG&A by $13.5 million and increased the consolidated SG&A rate by 70 basis points. If we exclude Ultra, the SG&A leveraged and I will discuss this in more detail on the next slide.

Our other operating income was $46.3 million, or 5.3% of sales, compared to $40 million, or 4.7% of sales last year. The increase was primarily due to higher interest earned on the higher outstanding receivable balance. So our consolidated operating income in the second quarter was $105.5 million representing 12% of sales. This was 100 basis points lower than last year and is primarily due to Ultra. As we exclude Ultra, our consolidated operating margin was 13.3%, up 30 basis points over the prior year.

In the US division, including Ultra, our operating income was $111.5 million or 15% of sales compared to $117.3 million, or 16.7% of sales, in the second quarter of fiscal 2013. When we exclude Ultra, the US division's operating income was $119.3 million, or 16.8% of sales, up 10 basis points. The operating loss for the UK division was $0.8 million, an increase of $0.5 million. And therefore, our consolidated operating income led to fully diluted earnings per share of $0.84 and if we were to exclude Ultra, the fully diluted earnings per share were $0.90, up $0.05 or [5.9%] (corrected by company after the call).

Now some additional detail on SG&A expense. Our SG&A remains well-controlled. As I mentioned, SG&A expenses were $250.5 million compared to $240.3 million in the second quarter of last year, up $10.2 million and as a percentage of sales, they increased by 40 basis points to 28.5%. This is primarily caused by Ultra, which added $13.5 million to our expenses driven by the operations and one-time acquisition costs. When we exclude the impact of Ultra sales and expense, the SG&A expenses decreased $3.3 million and leveraged by 30 basis points to 27.8% of sales primarily as we leveraged the US expenses. SG&A expenses in the UK declined $2.9 million reflecting the impact of our cost reductions and the currency fluctuation impact and this represented a slight deleverage due to the lower sales.

Turning to our share buyback program, of course, we continue to look at a variety of ways to deliver shareholder returns. Beyond reinvesting in operations, we have taken a shareholder-friendly view towards the use of our cash. In the second quarter, we authorized a $350 million share repurchase program of which $325 million remains. In the quarter, we repurchased approximately 375,000 shares of Signet stock at an average price of $66.74 per share. We ended the quarter with cash of $212.9 million, positioning our Company well for the holiday season.

Our net inventories ended the quarter at $1,417.7 million, an increase of $104.9 million, or 8%, from a year ago, but let's look at the reasons for this. The increase is primarily due to a $41.7 million increase in inventory for Ultra and a $32.3 million increase in diamond inventory associated with our rough diamond initiative. Excluding these items, our core inventory increased by 2.4%. Our inventory is well-positioned for the holiday season and we expect, by year-end, to be closer to prior year-end inventory levels as the inventory impact of Ultra and the rough diamond initiative will be less significant on a year-over-year comparative basis.

Now let's turn to credit, which remains an important component of our business. Our accounts receivable increased to $1,152.1 million, up 11.6% for the quarter. In the quarter, credit penetration, excluding Ultra, was 60.4% compared to 59.4% last year, attributed to increases in our bridal and branded product sales. It should be noted that our credit offerings were rolled out to Ultra stores in late June and we have seen an initial strong response, as Mike discussed. However, as a group, it is currently less than our historical base, which is why our credit penetration with Ultra is 59.1%

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versus 59.4% last year. We believe credit usage in these stores will continue to grow as we are in the early innings. The average monthly collection rate this quarter was 11.9% compared to [12.1%] (corrected by company after the call) last year as customers continue to opt for our regular credit terms, which require lower monthly payments as opposed to the 12-month interest-free program.

In the quarter, our bad debt expense increased to $36.5 million in the second quarter, an increase of $4.9 million, driven primarily by growth in the receivable balance, which accounts for approximately 75% of this increase. The remaining increase is attributed to a variety of factors, including slightly lower collection efficiency, as an example. The training and hiring of new staff to handle our volume increase has had a slight impact and changes in the credit mix, for example. Our regular credit terms, which carry longer repayment terms versus the 12-month interest rate is experiencing a slightly higher expense. We continue to believe the portfolio is performing well.

Offsetting the bad debt expense was an increase in other operating income, which is primarily interest income on the higher outstanding receivables and the shift away from the interest-free programs. The income on the portfolio was $46.3 million, or 5.3% of sales in the second quarter, an increase of $6.3 million.

Now the net impact on these two items, the bad debt expense and the other operating income, was income of $9.8 million in the second quarter as compared to $8.4 million in the prior year representing an increase of $1.4 million. As we look forward, we believe the third quarter will be impacted in a similar fashion with bad debt increasing versus last year's percentage of sales by 30 to 40 basis points and other operating income increasing 30 to 40 basis points with the two largely offsetting. This, again, will be primarily driven by growth in the receivable balance. In the year-to-date, we see a similar trend of increased bad debt offset by increased other operating income with a net impact benefit of $5.3 million.

Now let's turn to our third-quarter guidance. For the third quarter of fiscal 2014, the Company currently expects same-store sales to increase in the low single digit range. As a result, earnings per share are expected to be in the range of $0.37 to $0.43 based on an estimated 80.5 million weighted average common shares outstanding.

In the second quarter, we completed key actions for the integration of Ultra as planned and in the third quarter, we expect Ultra dilution to range from zero to negative $0.02. For the full fiscal year, we anticipate having a range of approximately 80.4 million to 80.8 million weighted common shares outstanding.

For the full year, the Company expects capital expenditures in the range of $180 million to $195 million, which includes costs related to the opening of 75 to 85 new Kay stores and several stores in the UK, our store remodels, digital and information technology infrastructure buildouts and outlet store channel integration. I will now -- thank you and I will now turn the call back to Mike.

Mike Barnes - *Signet Jewelers Limited - CEO*

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Rick Patel, Stephens.

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Rick Patel - *Bank of America-Merrill Lynch - Analyst*

Good morning, everyone and thanks for taking the question. Could you help us think about what happened to Ultra's gross margin on a sequential basis just comparing the first quarter to the second? On the surface, it looks like things got a little worse, but we are just trying to understand if it has to do with product, pricing or if it is just a transitional thing that you are going through right now?

Ron Ristau - *Signet Jewelers Limited - CFO*

You mean the operating margin at Ultra?

Rick Patel - *Bank of America-Merrill Lynch - Analyst*

Gross margin.

Ron Ristau - *Signet Jewelers Limited - CFO*

The operating margin at Ultra was affected in the second quarter by one-time exit costs. So therefore, the loss was about $0.06 in the quarter, as we had previously indicated. And as we said, the entire loss at Ultra, that $0.09 in the first half of the year, a lot of that is related to transitional and one-time costs. So as we move forward, we don't, of course, next year believe that that $0.09 expense will continue.

Rick Patel - *Bank of America-Merrill Lynch - Analyst*

And do you have confidence that the gross margin part of Ultra or at least the impact of that to the total gross margin line is going to improve as you go through the year?

Ron Ristau - *Signet Jewelers Limited - CFO*

I believe it will. I believe that the gross margin at Ultra will do a little better, yes.

Rick Patel - *Bank of America-Merrill Lynch - Analyst*

Great. And then can you talk to us about how we should be thinking about SG&A for the remainder of the year? I am curious if you can achieve leverage in the back half and how we should be thinking about the fourth quarter specifically given last year's 53rd week and the acquisition of Ultra?

Ron Ristau - *Signet Jewelers Limited - CFO*

Well, we don't give specific guidance on that. I think our SG&A spending, as I indicated, was well-controlled. If you look at our SG&A spending, excluding Ultra, we actually leveraged it and we believe that our excellent controls in SG&A will continue as we go through the year. That is probably the best I can say about that. We will experience some deleveraging as it relates to Ultra, but we expect that the base business will continue to perform well.

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Mike Barnes - *Signet Jewelers Limited - CEO*

I would just add to that, pretty much what Ron said and as he is talked about in his remarks earlier and that is we have had a successful transition of Ultra now. We had a dilution of $0.09 in the first half of the year. It is going to be very minimal Q3 and then it is going to become accretive. So as we continue to ramp up these new Kay stores that we have converted, things should look better over time.

Rick Patel - *Bank of America-Merrill Lynch - Analyst*

Great. And then just the last question around made-for-outlet products, just curious what you have learned from Ultra so far and how we should be thinking about that going forward.

Mike Barnes - *Signet Jewelers Limited - CEO*

That is a great question, Rick. We have learned a lot and prior to the acquisition, we were a much smaller player in the outlet market and we were operating the stores primarily as normal Kay stores within the outlet realm. And there is a lot of specialized marketing, not just merchandise, but specialized marketing that we have learned from them that we are going to put into place going forward that we think is going to be a real win for us, but also doing made-for product allows us to kind of engineer the products so that we can gear it for the bargain-hunting consumers that want to shop the outlet malls. And so we are going to have a much more desirable product mix out there for those consumers that like to shop the outlet mall.

So we think that with the learnings that we have got both from Ultra and now that we have a really solid team of people moving forward with a pure outlet strategy that we are just going to see more and more improvement over time. And like I mentioned, this is a channel of distribution that is actually growing in the US. They are building new developments. I think they are slated to have another 51 outlet malls open over the next three to five years I am not sure what the timeline was on that, but I heard that number the other day and we want to be a part of it. We want to be the leader in the outlet industry. We are going to have 120 outlet stores for Kay by the end of this year compared to only having about 30 last year. So we think it is a big win for us and we are looking forward to driving that part of the business.

Rick Patel - *Bank of America-Merrill Lynch - Analyst*

Thank you and congrats on a solid Q2.

Mike Barnes - *Signet Jewelers Limited - CEO*

Thank you.

Operator

Jennifer Davis, Lazard Capital Markets.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Hey, guys, good morning. First, Ron, could you help us understand third-quarter guidance? I guess I was a little bit surprised to see you guide to a decline in earnings. I think maybe part of it is the fact that Ultra is a lower margin business still. And then a follow-up to that would be how long do you think it will take for the outlets to reach the productivity levels of the Kay outlets?

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Ron Ristau - *Signet Jewelers Limited - CFO*

Sure. Well, the third quarter is -- Ultra is, of course, affecting that and you can see in our statements that we think Ultra will be -- it won't really contribute -- it might contribute negatively by a couple of pennies. We do believe it will become accretive in the fourth quarter of the year. I've always said we can't predict how rapidly the productivity should increase. Although we are seeing some good results out of the stores that we have converted to Kay and some light sales increases there.

So we are hopeful that next year will be significantly better than this year's results in Ultra and more importantly, as Mike indicated, Ultra is only a part of our outlet strategy. We have opened and will have just, exclusive of Ultra, 53 total stores that were just Kay to begin with because we have opened up quite a number of them this year. So by the end of the year, we will be operating 120 total combined Kay outlet stores and about 39, I believe it was, Ultra stores.

So as it goes forward, the outlet strategy should become a much greater contribution, but it is not just from the Ultra stores, it is the Ultra stores, as well as these new Kay outlet stores that we are opening up. When we think about the guidance in the third quarter, number one, we have given hopefully a prudent view of what we believe comps will be. We do expect that we will see some impact in our margins as it relates to the issue that we are having in bad debt, which we believe will be primarily offset by other operating income.

We have projected for now, because we will be doing a lot of test work in the third quarter in our UK business, but the UK business will continue to lose money in the third quarter, as it always does. But we have been a little conservative with our UK business because our idea is to allow them great latitude for testing and new products and to try some different things to get ready for the all-important fourth quarter to make sure that we are 100% positioned there.

So third quarter is our lowest quarter of the year, as you know and very small movements can cause some changes in the level of operating EPS for the quarter. For the full year, we think we are in very good shape and we will just have to get through this third quarter.

Mike Barnes - *Signet Jewelers Limited - CEO*

Jennifer, this is Mike. I would just add onto that, reiterate Ron's point. This is our smallest quarter of the year. Having said that though, as I mentioned, we started off positive in both the US and the UK and three weeks does not a quarter make, obviously, but we just wanted to give you an update on the trend as we start the quarter, as we usually do, at least a directional trend. But we are trying to be prudent with our guidance. Again, there is a lot of noise out there and gosh only knows what is going to happen in the geopolitical climate with all that stuff going on.

So we think that we are well-positioned to outrun the competition whether we are in good times, bad times or indifferent times and that is really the key year. We need to outpace the competition in whatever environment is given to us and that is what we always try to do. And frankly, in tougher times, we --generally, it is a little bit -- in my opinion, it is easier to gain marketshare in tough times than it is in good times because people start running for the hills.

While we still have our strength, our financial flexibility, we are able to invest and we are continuing to invest in so many great strategic initiatives and we are going to talk a lot about those at the Investor Day on October 8. So this is a situation where we feel great about the back half of the year. We feel well-prepared. We think the team is well-prepared. We are just being prudent. We like to be good forecasters of our business.

Ron Ristau - *Signet Jewelers Limited - CFO*

And there is one other point I would like to make, Jennifer, on your excellent question. In the third quarter this year, we have increased our advertising a little bit because of some new, exciting programs that we are going to be running in the September, October timeframe and we have taken a prudent view on the sales impact on that, but we have included in our guidance the additional advertising spending. So that is also having some impact. Yes, it's having some impact on our guidance. We will see how it all turns out.

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Mike Barnes - *Signet Jewelers Limited - CEO*

And that third-quarter TV advertising was not part of our program last year.

Jennifer Davis - *Lazard Capital Markets - Analyst*

All right, great. And I completely understand and the fourth quarter's when you generate about 50% of your earnings. So obviously, the fourth quarter is a quarter that matters. So Ron, can you quantify maybe how much you are planning on losing in the UK in the third quarter?

Ron Ristau - *Signet Jewelers Limited - CFO*

Well, we haven't been that specific, although I would say the level will be a little greater than that experienced last year.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Okay, all right. And then --.

Ron Ristau - *Signet Jewelers Limited - CFO*

Unless the business surprises us and gets a little better.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Right, well, that would be guidance.

Ron Ristau - *Signet Jewelers Limited - CFO*

We are planning it conservatively, I would say.

Jennifer Davis - *Lazard Capital Markets - Analyst*

Okay. All right. And then, finally, with your online merchandise, do you think you have an opportunity to expand that and begin to carry online exclusive merchandise and if so, when do you think we should start seeing that?

Mike Barnes - *Signet Jewelers Limited - CEO*

Well, I think that what we have the ability to do is to have an expanded range online, which I guess you could call that exclusive because it is not in the stores. We have physical limitations within the stores and then online, there are no physical limitations.

The other thing that we are doing is, and this is a really exciting program, is we are really ramping up our custom jewelry manufacturing and this goes beyond personalizing a ring. We have had Build a Ring for a while where you can pick the ring, you can pick the metal, silver, 14 carat gold, etc. You can pick diamonds, emeralds, rubies, whatever and you can kind of build the ring. But we have got a custom program in place that we are really putting a lot into where people can actually design custom jewelry themselves. They can walk in with a sketch and our guys have the ability to put it into 3D CAD renderings and design it out and get it custom-made and delivered. And what is the delivery time on that, Ron, do you remember?

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Ron Ristau - *Signet Jewelers Limited - CFO*

Less than two weeks.

Mike Barnes - *Signet Jewelers Limited - CEO*

Yes, it is like two weeks or less delivery. I mean this is custom-made jewelry to their specification. So it is a pretty exciting program and it is in early stages right now, but it is something that we believe has a lot of legs to it for the future. So a lot of the personalization that we can do, but, yes, I think that what we can do with our online business is we can have a much broader product offering and then it is going to continue to drive great performance for us. The US was up 36%. The growth that we have seen recently online has just been spectacular and we are looking forward to continue driving that business at full speed.

Jennifer Davis - *Lazard Capital Markets - Analyst*

All right, great and congratulations. Mike and Ron, you guys have done a great job since you started, I mean with the Ultra acquisition, the expansion of outlets and online and all of the strategic initiatives. So best of luck.

Mike Barnes - *Signet Jewelers Limited - CEO*

Thank you so much.

Ron Ristau - *Signet Jewelers Limited - CFO*

Thank you.

Operator

Jeff Stein, Northcoast Research.

Jeff Stein - *Northcoast Research - Analyst*

Hey, guys, a couple of questions. First of all, gold jewelry. With the price of gold coming down, are you beginning to see -- first of all, are you changing your strategy at all with regard to how you either price gold or perhaps bringing in more gold product for your customers now that it is becoming more affordable? It seems to me that gold jewelry sales have begun to pick up in the US during the second quarter and wondering if you are seeing that and what your strategy is in this segment of your business for holiday. Obviously, that is more of the fashion part of the business and therefore could weigh more heavily in the back half of the year.

Ron Ristau - *Signet Jewelers Limited - CFO*

Okay, that's a very good question. As it relates to gold, a couple of key points. Number one, the gold prices were favorable. They were more favorable a couple of months ago than they seem to be right now, but I would remind you that, number one, we are on an average costing system, so it will take us a little longer to realize the impact from gold swings in our P&L. It is not as dramatic as somebody on different inventory systems. So I would just make that point.

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We also see, with gold, some dynamics that are in our P&L that you might not be thinking about. Number one is it is favorable to us, of course, in our purchase of gold. It is also unfavorable to us as we scrap gold and go through our turn-in programs and so on. So there are some negatives that go throughout our P&L along with the benefits that we get and we are working through some losses that we have on our hedge positions from earlier in the year as we have disclosed that.

So all those things together are playing into the way we think about this. Be that as it may, there is still a benefit from gold. Having changed our strategy in pricing, I will let Mike speak to that a little bit. But, in the US, our pure gold business is not the lion's share of our business and it is more -- we do have some in the UK and in the UK, we have moved to take price adjustments in the UK and we are seeing some response in people repurchasing gold where it had been on a declining trend. So that is probably the biggest manifestation that I could speak to. Mike, I don't know if you want to add to that?

Mike Barnes - *Signet Jewelers Limited - CEO*

Yes, I would just add to that, Jeff, that Ron mentioned the UK. We have taken price adjustments in the UK to bring prices down quite frankly because of the move that we have seen in gold price. We tested that and it tested out very well and we have just, for the fall, kind of put it into motion. So we have high hopes that that is going to help what has been a difficult gold business for us in the UK because the UK does sell a pretty good amount of gold. They have a little bit more balanced merchandise mix in the UK whereas 75% of our business is some type of diamond jewelry type jewelry in the US.

So we think that we are going to get a benefit in the UK from the gold. We will see the benefit as it rolls through our inventory. But, to Ron's point, it is on an average basis. So it takes about a year for changes in prices to really roll through and to his point, on the scrap side, you get that hit immediately as you are scrapping. So there are a couple of different moving parts in there. Overall, net, net, net, it is going to be a benefit like Ron said and we are hoping that the prices remain stable.

Ron Ristau - *Signet Jewelers Limited - CFO*

And I hope we don't wake up tomorrow and see gold back up to $1700.

Jeff Stein - *Northcoast Research - Analyst*

One additional question, Ron and again, this gets back to the third quarter. In your prepared remarks, you kind of indicated that you expect your credit income to be up in the third quarter. Ultra is going to be kind of breakeven. So I am just trying to isolate how much of your guidance in Q3 is just being cautious and conservative and how much of it is, for example, this bump in marketing or is credit expected to possibly get worse before it gets better and if that is the case, maybe you can talk a little bit about some of the execution issues you are having on training and so forth as (multiple speakers).

Ron Ristau - *Signet Jewelers Limited - CFO*

Sure. Well, first, I don't believe credit will get worse before it gets better; let me be clear about that. It just won't. What I said about the third quarter was that I expected it to be up. There is two components to it, the bad debt, which sits up in our gross margin and I think that that will be up 30, 40 basis points versus last year primarily on the basis of mix -- I'm sorry -- on the basis of growth in the receivable balance and with a small little impact from the mix and efficiency, as I discussed in the second quarter. And I believe that that will be largely offset by increases in other operating income.

So the two will move in tandem and have de minimis impact on the P&L, Jeff, net, okay? So when I think about the guidance for the quarter, number one, we have included in there some additional spending on advertising. We have prudently not really projected a lot of sales on that. We will see

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how it turns out. It is really the first time we have done this, so that is impacting our guidance somewhat. So that spending range is impacting the numbers for sure.

Mike Barnes - *Signet Jewelers Limited - CEO*

It's an interesting dynamic, Jeff. As the non-financial guy here in the room, I find it very interesting that as customers shift more to our regular interest paid program, they get lower payments, but it stretches out the payments longer. Because you have that receivable sitting out there for a longer time period, it generally doesn't operate quite as well as a 12-month interest-free program, but you get the benefit of collecting that interest and as Ron mentioned earlier, on a net basis, we actually came out to the positive by I think it was $1.4 million.

Ron Ristau - *Signet Jewelers Limited - CFO*

Yes, that's correct.

Mike Barnes - *Signet Jewelers Limited - CEO*

So it is a little bit of a trade-off there, but because of the interest collections going up, the other operating income, it actually has been a positive net for us in the second quarter.

Ron Ristau - *Signet Jewelers Limited - CFO*

And I would point out, Jeff, that the metric that we have all grown used to using and we present, by the way, which is bad debt as a percentage of sales, it will go up because the receivable balance is growing at a faster rate than sales because of the penetration increases. We have been talking about that for I think two years now, that that is going to go up somewhat, but it is driven by the volume increase and that is a pretty easy number to calculate.

Jeff Stein - *Northcoast Research - Analyst*

Sure. And Ron, could you possibly quantify the increase in marketing spend, the incremental marketing spend for Q3?

Ron Ristau - *Signet Jewelers Limited - CFO*

I don't think we can be that specific; I really can't be that specific. It is significant, but not a huge number. The problem you have in the third quarter is that small movements in these numbers move the EPS a couple of pennies. So it looks, because it is a small quarter, you get a little more distortion, which I'm sure you know from working the model yourself.

Jeff Stein - *Northcoast Research - Analyst*

Sure. Okay. Thank you.

Mike Barnes - *Signet Jewelers Limited - CEO*

Thank you.

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Operator

Bill Armstrong, CL King & Associates.

Bill Armstrong - *CL King & Associates - Analyst*

Good morning, Mike and Ron. Just to follow up on some of that. So the bad debt issues, are these training and internal issues or are there any issues with your customer mix and maybe the ability to pay?

Ron Ristau - *Signet Jewelers Limited - CFO*

No, I wouldn't say there is any issue with our consumers' ability to pay. Our overall credit portfolio statistics continue to remain very strong and I want to make sure that you understand that point. When we look at the bad debt issue again, about 75% of it, so, in the quarter, we had a $5 million increase in our bad debt, about $3.5 million, $3.6 million of it is directly traceable to increases in the volume, with the residual being comprised of several things.

Number one is the impact of this change in the credit programs that people are selecting. Remember, this phenomenon started like last year and we are seeing now as it works its way all the way through the cycles that it is increasing the risk slightly. I mean it is a couple of hundred thousand dollar impact in there, maybe as much as $0.5 million. And the residual, we are having some short-term issues because of the 12% [crook] in the receivable balance that we experienced is that we have had to bring on a lot of new people and train them and get them up to speed and we are seeing some -- it is a high-volume activity. So as you make small changes in the activity that pass through to collection, we have seen some impact there, which we hope to correct as we go forward in the next quarter or two.

But I don't think there is anything wrong with our consumers' ability to pay. Consumers are behaving strongly. They are making more than the minimum down payments very strongly. They are using the credit appropriately. Our credit approval rates remain relatively consistent to prior year, so there is no big change in anything that we are doing there. So I don't want to cause any alarm, but I do want to properly describe the situation. It is mostly volume with some tweaks, if you will, in the collection profile primarily caused by the change in these programs.

Mike Barnes - *Signet Jewelers Limited - CEO*

All the indicators that we track that speak to the health of the consumer have stayed very strong and not only are they making more than the minimum down payment, but they are continuing to overpay their monthly payment at a strong rate as well. So the indicators, as far as the health of the consumer, have been good.

Bill Armstrong - *CL King & Associates - Analyst*

Okay. And then I guess part of this guidance still reflects the higher advertising expense, but it sounds like you are not -- you are assuming no actual sales benefit from it. So I guess why bother doing these advertisements?

Ron Ristau - *Signet Jewelers Limited - CFO*

Well, people have to test things every now and then. You have to see what happens when you try to do something that is a little different. I didn't say we didn't put any impact; I said we have been conservative of the impact. We will see how it all turns out. If you never try anything new, then you never get the different results. So sometimes you have to try and test things and we've tested these programs and we believe they will be effective. So let's see what happens. Again, it is a component; it is not a --.

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Mike Barnes - *Signet Jewelers Limited - CEO*

Yes, it is a new program that we haven't done before and it is a test, so we were naturally conservative on the impact. But, of course, yes, we expect to see some impact from it.

Bill Armstrong - *CL King & Associates - Analyst*

Okay, okay, fair enough. And just kind of broadly, mall traffic is kind of soft. Apparel retailers are reporting softness in sales. Are you guys seeing any impact on that and maybe more in the fashion jewelry side compared with the bridal side?

Mike Barnes - *Signet Jewelers Limited - CEO*

Well, as we said, we started off on a positive in both the US and the UK, but with the macro retail environment being what it is, we have all seen the same reports from the companies that you are referring to on the apparel side. We are being prudent about our expectations to some degree, but we started off positive and we feel well-prepared for the back half of the year. So that is kind of where we are at. We have given the guidance out there and we have given a little bit of directional color on how we started off in August and that is pretty much as far as we can go along those lines.

Bill Armstrong - *CL King & Associates - Analyst*

Okay. And then just final question, it looks like you have increased your store openings by about five units this year. Anything to call out there, what's maybe the thought process behind that?

Mike Barnes - *Signet Jewelers Limited - CEO*

Yes, the real estate team is doing a great job. Ron and I have been asking these guys to continue finding these great locations that they have done so well at over the years and to speed it up because the stores that we are opening have been doing very well and we are stretching into other areas. We began a number of years ago opening Kay off-mall stores in centers, power type centers, etc. They have done very well, just like Jared has and so we have asked them to continue doing the great job they are doing and find some more successful real estate for us. And they are succeeding at it, thank goodness.

So we are very pleased to be opening the number of stores that we are. I think it is fantastic. We are in a little bit of a growth mode here. With the acquisition and plus the organic stores that we are opening, we are excited about the future and we think we have got a great long-term strategy to really drive this Company higher and higher over time.

Bill Armstrong - *CL King & Associates - Analyst*

Okay, great. Thanks very much.

Operator

Lorraine Hutchinson, Bank of America.

Lorraine Hutchinson - *Bank of America-Merrill Lynch - Analyst*

Thank you, good morning. Just one longer-term question on credit. As you roll the programs out to your outlet customer, how do expect that to change your bad debt reserves or metrics?

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Ron Ristau - *Signet Jewelers Limited - CFO*

Well, it's a very good question. We don't have a different scoring mechanism for outlet customers as opposed to normal mall customers. So the outlet customers must meet the same credit-granting profile, if you will. So we do not expect that it will be significant in any way. What we saw as we rolled it out, as Mike indicated, just to reiterate, when we purchased the Company, the credit penetrations were in the low 20s given the programs they were offering. We started in late June to roll out our credit offering to the stores. So they really have been added a little better not even two months yet and it jumped from the low 20s up to around 40 because people have to learn how to sell the credit and what the benefits are and so on. But we thought that that was a very good, short-term impact. That was a move in about a six-week period.

We are not experiencing as of yet, nor do we anticipate to experience any major changes in the bad debt because the way people select the program is the same and the programs they select are the same. So therefore, it shouldn't be different. It is not like the credit consumer there is less worthy. We will see how the approval rates go. We don't know over time where the approval rates will be, the same or different, but as long as you are not changing the criteria, what should change is the approval rate. If it is a lower quality credit then it should be lower approval rates. But we don't have enough information at this point in time. Does that answer your question?

Lorraine Hutchinson - *Bank of America-Merrill Lynch - Analyst*

It does, yes, thanks. And then when you think about the holiday calendar with six fewer days between Thanksgiving and Christmas, do you view that as a comp hurdle and how are you changing your marketing and merchandising to reflect that?

Ron Ristau - *Signet Jewelers Limited - CFO*

Well, what that means is that every single week and every single weekend are very important and so what it means is that we have taken a very careful look at our calendar. We have made sure that we feel we have a robust calendar with events, with marketing. We have upped our marketing spending and impressions during the timeframe. So it just means you have no -- there is no room for error and you have got to be right on top of it and we are, I can assure you.

Lorraine Hutchinson - *Bank of America-Merrill Lynch - Analyst*

Thank you.

Operator

Brian Tunick, JPMorgan.

Brian Tunick - *JPMorgan Chase - Analyst*

Thanks. Good morning, guys. Two questions. I guess, maybe, Mike, just on the bigger-picture side, what do you think the industry consolidation looks like from here? Do you expect the pace of industry closings to slow? Are you seeing the department stores reenergize and doing something different in the category? And then, on the UK side, can you maybe talk about the recent management changes you have made and how that affects your thoughts on maybe getting back to that I think you said 10% operating margin goal longer term? Thanks very much.

Mike Barnes - *Signet Jewelers Limited - CEO*

Sure. Thank you. On the consolidation side, it has slowed as we have gotten further and further from the old dark days of the recession five years ago or so and I think it has stabilized and it continues to consolidate, albeit a little bit slower year to year to year. We believe that we are primed to

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continue to take marketshare from that consolidation. It is interesting. I'm glad you mentioned the department stores because one of the things that we focus on here is making sure our team understands -- know who your customer is and don't be focused on only specialty retail jewelers. Because there are these big guys out there like the department stores of the world and some of the mass merchants that are considerable competition to us in the mid-market jewelry. And we have to realize that and focus on it and continue to drive great product selections that our customers desire to win that game.

It was just fairly recently, a couple years ago, that we overtook Walmart quite frankly and became the number one jewelry retailer in America, not just the number one specialty retail jeweler, but the number one jewelry retailer. So even as the specialty retail jewelry market has consolidated down, we have continued to grow, not only within specialty retail jewelry, but also within jewelry in general as far as retailing in America. So we feel very good about continuing on that path that we have been on and we think that we are well-prepared to do that.

As far as the UK, we have had management changes there. Rob Anderson has decided to leave the Company and we have promoted Sebastian Hobbs, who was our Commercial Director for the past 2.5 years, to the Managing Director position in the UK. Seb is a great leader. He has got a great eye for the commercial business out there and the marketing side of things. So we think that he is going to continue to drive the UK to become better and better in their product offerings and their marketing objectives and in really driving the business.

We have also had some promotion on the store operations side. We have promoted an eight-year veteran to the position of Director of Store Operations and she is a fantastic individual. It is working out very well. The transition has gone very well. As I said, we actually started off positive first three weeks of August, which was a nice trend change and I know that is not a long trend, but we will take what we can get and continue to build upon it. So there is a lot of exciting things happening.

We are also continuing to really work in collaboration between the UK and the US teams and this is an exciting thing. They are more collaborative than they have ever been. In the US management team starting at the top with Mark Light as the CEO, our Senior Vice Presidents of Merchandising, of Store Operations, they are all very excited to be working in collaboration with the UK. And the idea is we want to find best practices wherever they sit. Best practices can come from anywhere and they can be executed everywhere.

And so we are having the teams work together to find the best practices and this is a long-term strategy for us and we believe it is going to be very successful. We have already started working on a lot of the same product ranges. The UK tested the Neil Lane range last year. It did very well. And they are rolling that to a lot more stores for holiday. So there are a lot of exciting things happening in the UK. Everyone is really pumped up about the direction that we are going. We do still have our eye on that 10% operating income and we believe that we can get there and we believe that we have got a team on the ground that can make it happen working in close collaboration with our team here in the US.

Brian Tunick - *JPMorgan Chase - Analyst*

Mike, that sounds very exciting. Just one quickly for Ron. On the 75 to 85 stores this year, is that the right place for us to be thinking as far as next year as well from a planning and budgeting perspective? Is that the right either square footage growth rate --?

Ron Ristau - *Signet Jewelers Limited - CFO*

I would tell you that -- I would certainly say -- we will probably say more about this at our Investor Day. I don't think our range in the future will be significantly different, although we would really like to give you an update at our Investor Day on that issue as we take a look through our budgets and so on. We are seeing, as Mike indicated, some nice real estate opportunities. We are doing a great job in our real estate community with that and I don't think it will be materially different. But before I lock in an exact range, I would like to defer and wait till then.

Brian Tunick - *JPMorgan Chase - Analyst*

All right, sounds good. Thanks again.

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James Grant - *Signet Jewelers Limited - VP, IR*

Operator, I think we have time for about one more question at this point.

Operator

Oliver Chen, Citigroup.

Oliver Chen - *Citigroup - Analyst*

Hey, thanks, guys. Congrats on all the consistency.

Mike Barnes - *Signet Jewelers Limited - CEO*

Thanks, Oliver.

Oliver Chen - *Citigroup - Analyst*

Regarding the environment that we are seeing now, we are seeing national specialty competitors get a little bit stronger, probably thanks to a lot of execution around similar strategies on better proprietary product in bridle. So what are your thoughts there in terms of your competitive flexibility going forward and what kind of levers you may have? And also how is the competitive environment in your view?

Mike Barnes - *Signet Jewelers Limited - CEO*

Thanks, Oliver. Yes, you are absolutely right. Our competitors are not standing still. They are all running at us and of course, their goal is to take the business and we don't want to let them have it. We intend to continue gaining profitable marketshare and a lot of the successful things that we have done over the years, people are going to emulate those. And if it is a successful strategy, it might work for them as well and there are a lot of competitors out there that are trying to do that.

So what we have to do is we have got to continue moving fast. We have got to be innovative, we have got to be fresh, we have got to have new products and we have just got to stay in front of it. And that is the best way to compete in this industry. We have got a team that can do that. This team is nimble. They are very experienced and they are continuing to drive some great ideas in marketing, great ideas in execution in the field, great marketing merchandise. This is what we have to do to stay in front of it. And that is what we are doing.

We intend to stay the number one jeweler in America and in the UK and we are going to do everything in our power to keep moving forward. That is our job. Their job is to try to catch us. Our job is to try to keep them in the rearview mirror. So we are working towards that and I believe that we are going to be successful. We have worked on some big strategies and we have a strategic vision with a lot of great new innovative ideas going forward. We are going to a talk a little bit about strategy at our October Investor Day conference on October 8. So I hope that you and everyone else can be there because it is going to be an exciting day. And we will lay out a little bit more about what we are doing to really win in this environment.

Oliver Chen - *Citigroup - Analyst*

Thank you, Mike. And as a final one, Mike and Ron, could you just share us with your thoughts on the health of the consumer? From this perch, we are just getting all these mixed messages. And I was just curious on your thoughts on how the consumer feels and if they are thinking there is continued volatility in the marketplace or if you think that they feel encouraged about the ability to spend?

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Mike Barnes - *Signet Jewelers Limited - CEO*

I think the consumer is fairly healthy, but they run in cycles. And I think that from what I have heard from the macro environment, they have been focused a lot on different categories and it moves around. I saw a positive comment about gross domestic product this morning coming out in the US. So hopefully, the consumer will continue to gain strength over time. Again, we can only talk about how we feel and we feel well-positioned for the back half of the year and unless we see some dramatic trend changes or have some big black swan event that hits us. So I think we are well-prepared and I think the consumer will be there for us.

Oliver Chen - *Citigroup - Analyst*

Thank you. Best regards.

Mike Barnes - *Signet Jewelers Limited - CEO*

Thank you.

Operator

I will now turn the call over back to Mr. Barnes for closing remarks. Please go ahead.

Mike Barnes - *Signet Jewelers Limited - CEO*

Thank you so much. And thanks to all of you for taking part in this call. We really appreciate it. Our next scheduled call is on November 26 when we will review our third-quarter results. But, remember, before that, we do have our Investor Day conference in New York City and that is on October 8. I hope to see you all there. Thanks again and goodbye.

Operator

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

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