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SIG - Signet Jewelers Ltd Q4 and Full Year Fiscal 2014 Earnings Conference Call

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OVERVIEW:

SIG reported FY14 operating income of $570.5m and diluted EPS of $4.56. 4Q14 total sales were $1,564m, consolidated operating income was $270.6m and fully diluted EPS was $2.18. Expects 1Q15 diluted EPS (prior to acquisition costs) to be $1.24-1.28.

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PRESENTATION

Operator

Welcome to the Signet Jewelers fourth-quarter and full-year fiscal 2014 results conference call. My name is Jon and I will be the operator for today's call. At this time, all participants are in a listen-only mode. (Operator Instructions). 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 fourth-quarter and 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 under the Investors section of our website, SignetJewelers.com. Following Mike and Ron's prepared remarks, we will conduct a question-and-answer session about Signet operations. During our Q&A, questions should be limited to the operations of Signet. We will not be answering questions on Zale as the transaction has not closed.

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 today with the SEC. We also draw your attention to slide number 2 in today's presentation. And now I will turn the call over to Mike.

Mike Barnes - *Signet Jewelers Limited - CEO*

Thanks, James and good morning, everyone. We are pleased with our fourth-quarter results and our full-year results. For the quarter, comp store sales at Signet increased by 4.3%. Our US division comps grew at 4% compared to a 4.9% increase last year. In the UK, comp store sales increased 5.7% as the team continued its strong momentum coming out of the holiday season and on through the end of the quarter. E-commerce sales for Signet were up by 23.6% as our string of impressive double-digit growth rates continued in Q4. Signet delivered record Q4 profit driven by the

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strong execution of our strategies. Our operating income was $270.6 million, up $2.9 million, or 1.1% and diluted earnings per share were $2.18, up $0.06 or 2.8%.

In the fourth quarter, the US division results were driven by strong performance across a variety of merchandise categories. Bridal, colored diamonds, fashion jewelry, beads and watches all performed very well. Our branded differentiated and exclusive brands increased by 21.8% reaching 31.1% of sales for the year. Once again, we had an impactful advertising campaign and our store execution was strong.

In the UK division, results were driven by growth in bridal and fashion diamond jewelry, as well as fashion and prestige watches, exclusive of Rolex, which was offered in fewer stores. Our in-store teams executed with a renewed enthusiasm and drove results throughout the quarter. Lastly, in the fourth quarter, our teams did the bulk of the hard work necessary to set the stage for the February announcement regarding the Zale acquisition.

I will take a few moments at this time to review some of the key takeaways on the Zale deal before I resume discussion on the Signet full-year performance. The transaction is, of course, subject to Zale stockholder approval, certain regulatory approvals and customary closing conditions. But we expect it will close sometime within calendar year 2014. We are all very excited by the great potential this acquisition allows for. We realize there is a lot of work in front of us, but the benefits and the opportunities that this brings to our customers, suppliers and team members is tremendous.

The addition of Zale will help us support our midmarket and best-in-bridal strategies. It also provides digital ecosystem opportunities and gives us a very strong position in Canada. The timing of the acquisition works well. The Zale team has really done an outstanding job of returning the company to profitability. Soon, working together with Signet resources and know-how, we believe that we can take our companies to a greater level of success.

We are in a strong position to cost-effectively finance this transaction as well. We expect to utilize approximately $600 million of receivables securitization and $800 million of other debt financing to complete the transaction. This cost-effective financing, as well as our ability to evolve and better optimize our capital structure, will also enable improvements in the level of our tax efficiency. The evolution of our capital structure includes the potential for further securitization of our accounts receivable as our Company grows and cash flow predictability of the combined entity stabilizes.

We have identified clear opportunities for approximately $100 million in synergies within the first three years after this deal closes and we will continue to develop additional ideas after the deal closes as we work closer together. To that end, we are beginning our planning for integration and we have decided to partner with McKinsey Consulting to work together with our internal teams to ensure success.

Now I'll turn to the results of our fiscal year 2014. Our comp store sales increased by 4.4%. The US, which represents about 84% of our sales for the year, delivered 5.2% comps, which was outstanding after an increase of 4% last year. In the UK, we delivered a positive 1% comp and that is the best we have seen in six years. The comp store sales growth led to record profit for the year. Our operating income was $570.5 million, or an increase of 1.8% and diluted earnings per share was $4.56, up 4.8%.

There were other highlights beyond just the income statement as well. We repurchased 1.9% of our outstanding shares in fiscal 2014. We also increased our dividend in the first quarter by 25% and I am very happy to say we announced today another dividend increase, this time by 20%, to $0.18 per share per quarter. During fiscal 2014, we strengthened our strategic diamond-sourcing initiative in a variety of ways, including the purchase of a rough to polished manufacturing facility in Botswana. And we increased our square footage globally by 4% by opening 63 new Kay and 13 new Jared stores. I'd like to thank all of our team members worldwide for a year of outstanding results with their tremendous efforts.

Now let's take a little bit of a closer look at the US division annual performance. In the US, total sales were $3.5176 billion, up $243.7 million, or 7.4%. Our same-store sales increased by 5.2%. Kay comps led the way with a 6.5% increase while Jared increased by 4.7%. The success in both concepts was driven by a variety of merchandise categories.

The US e-commerce business performed very well with sales up $27.6 million to $129 million or an increase of 27.2%. The US division operating profit increased by 1% with a 15.7% operating margin. Ron is going to add a little bit more color on this in just a couple of minutes.

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Now I am going to move on to some of the key drivers of this performance starting with the merchandise. Our merchandise sales growth was very broad-based with strong growth across both the bridal and fashion jewelry categories. In fiscal 2014, branded differentiated and exclusive merchandise gained relative share within our product portfolio. The category grew by 23.2% and ended the year accounting for 31.1% of our merchandise sales mix and that is up 370 basis points. This growth was led by our colored diamonds and gemstone collections. Those include Le Vian, Artistry, Vivid and Shades of Wonder. Also, our branded bridal collections saw strong growth, including brands such as Neil Lane Bridal and Tolkowsky diamonds. And Neil Lane Design and Open Hearts by Jane Seymour were important contributors to branded growth within the designer fashion merchandise.

Looking beyond the branded differentiated merchandise, overall bridal sales increased a double-digit percentage, enough to gain a small amount of relative share within our merchandise portfolio. Our leadership in marketing and advertising continues to be an important driver of our US sales as well. Everyone knows that Every Kiss Begins with Kay and that He Went to Jared. For the holiday season, we created fresh new TV ads continuing to build upon our industry-leading share of voice.

In fiscal 2014, our advertising investment in the US increased to $233.6 million. Our branded differentiated and exclusive merchandise continued to provide compelling stories that we communicated very effectively and efficiently with our messaging. The bottom line is our compelling marketing and advertising continued to drive strong purchase intent.

Another driver in fiscal 2014 results was the strengthening of our digital ecosystem. We evolved Kay.com and Jared.com from the previous year's redesign. We optimized the customer experiences for both desktop and mobile devices and we created mobile apps, which have a variety of features such as allowing customers to pay their credit balances from their mobile phones.

We also created an online education center called jewelrywise.com, which is an excellent resource for customers who want to know more about jewelry in a more objective and a softer sell kind of environment. We surround customers with e-commerce and social media touch points and we engage them in digital ecosystem marketing, not only through Kay.com and Jared.com, but also through Facebook, Twitter, YouTube and other points of interaction. As a result, we created outstanding customer experiences in all channels. Our success in the digital ecosystem is validated in part by the tremendous three-year growth rate of our e-commerce sales, which is over 34%.

Now I'll turn to some of our UK performance. Total sales in fiscal 2014 were $685.6 million. That was down $23.9 million or 3.4% due to fewer stores. Comps sales, however, increased by 1% compared to an increase of 0.3% last year. This comp increase was driven by a strong fourth quarter at Ernest Jones, driven through bridal and fashion diamond jewelry, as well as prestige watches, exclusive of Rolex, which, as I mentioned, was offered in fewer stores. It was driven at H.Samuel primarily through bridal and fashion diamond jewelry and fashion watches. E-commerce sales in the UK were $35.1 million and that is up $6.7 million, or a very strong 23.6%. Operating income was $42.4 million for the year, an improvement of $2.4 million from the prior year. Operating margins increased by 60 basis points, which is a great sign that our turnaround program in the UK is well on track.

We remain committed to our UK long-term plan and we have a series of activities underway to deliver sustained growth and a 10% operating margin. Collaborating closely with the US division, our UK division is focused on continuing to develop our people, selling systems and customer service. The UK is focused on merchandise initiatives as well such as best in bridal, which will continue to showcase brands and store processes to reinforce our growth initiatives. We are also engaged in ongoing development of our fashion jewelry programs and committed to strengthening our partnership with the watch brands.

Another main focus is the ongoing investment in key real estate, rolling out new store designs and continuing to develop our growing digital ecosystem business. And finally, discipline on cost remains a key element of our performance improvement.

In conclusion, fiscal 2014 was a successful year not only because of record financial results, but also because we successfully supported our mission to help customers do two things -- celebrate life and express love. We have been building upon our midmarket success and staying true to the heritage of our core brands. We grew our bridal business through initiatives around field operations, merchandise, marketing and procurement. We advanced our digital ecosystem, as I discussed a little earlier and in the near future, we are also expecting to achieve a big win around our strategy of geographic expansion and expanding our footprint upon the close of our Zale acquisition.

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But in the meantime, I am very proud of what our team accomplished during fiscal 2014 and now I am going to turn the call over to Ron for some financial color on the fourth quarter and the full year. Ron?

Ron Ristau - *Signet Jewelers Limited - CFO*

Thank you, Mike and good morning, everyone. I will focus my comments today primarily on the fourth quarter and I will start by reviewing the fourth-quarter sales in more detail. For the quarter, total sales for Signet increased 3.4% to $1.564 billion compared to $1.5133 billion last year. Same-store sales increased 4.3% compared to 3.5% growth in the prior year.

In the US, our total sales increased 3.5%, or $43.1 million, to $1.288 million, which included a same-store sales increase of 4%. Our non-same-store sales were up 3.2%. Sales increases were driven by a variety of merchandise categories. By category, bridal, colored diamonds, fashion jewelry, beads and watches all performed well. The number of merchandise transactions increased in both Kay and Jared. Average merchandise transaction values increased in Kay primarily due to higher sales of branded merchandise. Average merchandise value declined in Jared primarily driven by sales mix due to higher bead sales.

In the UK, total sales increased 1.4% or $3.8 million to $272.2 million. Comp store sales increased by 5.7%. UK sales performance in the fourth quarter was primarily driven by growth in bridal and fashion diamond jewelry, as well as fashion and prestige watches, exclusive of Rolex, which was offered in fewer stores in fiscal 2014. Average merchandise transaction value was consistent with the prior year in H.Samuel and declined slightly in Ernest Jones, primarily due to sales mix. The number of merchandise transactions increased in Ernest Jones due primarily to increased focus on the bridal business and sales of watches. The decrease in H.Samuel was primarily due to continued store closings. Signet e-commerce sales in the fourth quarter, as Mike mentioned, were $79 million, up $15.1 million, or 23.6%.

Now let's review the components of operating income. Our Signet gross margin was $648.8 million, an increase of $11.7 million. The gross margin rate was 41.5%, down 60 basis points. In the US, gross margin dollars increased $9.1 million compared to the fourth quarter of fiscal 2013, reflecting higher sales, partially offset by a gross margin rate decline of 70 basis points. The lower gross margin rate primarily reflects the net impact of gold hedge losses associated with the decline in gold prices earlier this year, fourth-quarter promotional programs and year-end inventory adjustments, partially offset by favorable pricing. The US net bad debt expense to US sales ratio was 3.5% compared to 3.3% in the prior-year fourth quarter.

In the UK, gross margin dollars increased $3.4 million compared to the prior-year fourth quarter, primarily reflecting the impact of higher sales and a gross margin rate improvement of 70 basis points. The increase in the gross margin rate was primarily a result of store occupancy savings associated with store closings and lower store impairment charges, partially offset by planned promotional activities in the key holiday gift giving period.

Signet's selling, general and administrative expenses were $425.8 million compared to $410.9 million in the prior-year fourth quarter. It's an increase of $14.9 million and as a percentage of sales increased 10 basis points to 27.2%. I will discuss this in more detail on the next slide.

Other operating income was $47.6 million or 3% of sales compared to $41.5 million or 2.7% of sales last year. This increase of $6.1 million was primarily due to higher interest income earned from higher outstanding receivable balances. So our consolidated operating income in the fourth quarter was $270.6 million representing 17.3% of sales. By segment, the US division operating income was $227.9 million, or 17.7% of sales as compared to $227.5 million, or 18.3% of sales in the fourth quarter of fiscal 2013 and the operating income for the UK division was $51.7 million, or 19% of sales compared to $48.8 million or 18.2% of sales in the fourth quarter of fiscal 2013. Our fully diluted shares -- fully diluted earnings per share were $2.18.

Now some additional detail on SG&A expenses as I stated earlier. SG&A expenses of $425.8 million compared to $410 million in the fourth quarter of fiscal 2013. In the US, SG&A expenses increased by $15.6 million. The primary reason for the increase was advertising expenses made in anticipation of higher sales than we actually achieved. And overall, SG&A expense in the UK was relatively consistent with the prior year as savings that we did generate as a result of our savings program were redeployed to advertising and store support. Our SG&A remains effectively controlled and focused.

Our ending inventory was $1.488 billion, up $91 million, or 6.5%. This includes inventory on our new store program as we had approximately 83 new stores. New stores increased inventory by $40 million. We made an additional increase in bridal investment to support our best-in-bridal

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initiatives. This represented $20 million of the increase. Our diamond-sourcing initiative was up by $17.4 million over the prior year and in the UK, our inventory was up $14 million primarily due to foreign currency translation increases. Excluding the increases due to foreign currency and diamond sourcing, our inventory was up by 4.2%. We continue to believe our inventory is very well-positioned to support our first-quarter sales.

Our credit portfolio continued its strong performance. Net accounts receivable increased to $1.374 billion, up 14% for the quarter. In the quarter, the credit penetration was 55.5% compared to 53.5% last year. This is attributed primarily to increases in branded bridal sales and strong customer acceptance of our credit offerings. The average monthly collection rate this quarter was 11.5% compared to 11.9% last year as customers continue to opt for our regular credit terms, which require lower monthly payments as opposed to the twelve-month interest-free program.

Our bad debt expense was $45.5 million for the fourth quarter, driven primarily by growth in receivable balance from increased credit penetration and change in the credit program mix. Offsetting the net 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 these programs was $47.6 million, or 3% of sales in the fourth quarter.

The net impact of these two items was income of $2.1 million in the fourth quarter compared to $0.4 million in the prior year, an increase of $1.7 million. In the year to date, we see a similar trend of a slight increase in bad debt caused by an increase in receivable balance offset by increases in other operating income. The net income impact was $48.4 million versus $39 million last year, a net benefit of $9.4 million on the year.

Now turning to our first-quarter fiscal 2015 guidance. For the first quarter, the Company currently expects same-store sales to increase in the 3% to 4% range. The first-quarter diluted earnings per share prior to acquisition costs are expected to be in the range of $1.24 to $1.28 with acquisition costs impacting EPS by a negative $0.10 to $0.08 resulting in first-quarter diluted earnings per share in the range of $1.14 to $1.20 based upon an estimated 80.3 million weighted average common shares outstanding.

The recently announced pending acquisition of the Zale Corporation will result in the realization of incremental expenses prior to the close of the transaction as the final close date is dependent upon Zale stockholder and regulatory approval and the satisfaction of closing conditions. These expenses will primarily be transaction-related costs such as legal, tax, banking and consulting expenses, which are expensed as incurred and financing fees, such as bridge financing fees, incurred prior to establishment of the new capital structure.

For the full year, the Company expects a range of capital expenditures estimated between $180 million to $200 million. This includes the opening of 75 to 85 new Kay and Jared stores and one new store in the UK, the cost for store remodels and continuing our digital and information technology infrastructure buildouts. Thank you very much and I will now turn the call back to Mike.

Mike Barnes - *Signet Jewelers Limited - CEO*

Thanks, Ron. I would like to again just thank all of our Signet team members worldwide for the great contributions to a successful quarter and to the fiscal year 2014. Now we would be pleased to take any questions that you have, but again, as James mentioned, during our Q&A, questions should be limited to the operations of Signet. We are not answering any questions on Zale as the transaction has not yet closed. Thanks again and let's begin the Q&A session please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Eric Beder, Brean Capital.

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Eric Beder - *Brean Capital - Analyst*

Good morning. Congratulations on a solid quarter.

Mike Barnes - *Signet Jewelers Limited - CEO*

Thank you, Eric.

Eric Beder - *Brean Capital - Analyst*

When you look into 2014, I know that you have changed the cadence a little bit with the advertising. You were a little more aggressive in down periods. I am curious how that is going to be reflected in 2014 and when you look in Valentine's Day, how did you guys continue to do extremely well even with the bad weather and traffic patterns you have seen with other players?

Mike Barnes - *Signet Jewelers Limited - CEO*

The weather, I will take that one first, and then I will talk about the advertising a little bit and what we did and what we think -- what we are thinking about going into this year. It's very interesting, Eric, because we got impacted -- when Mother Nature decided to deal her blow, we got hit just like everybody else and it was pretty tough. There were periods of time where we had to close stores because of the weather. Certainly the customers weren't coming out. It was not only the snow, but just be bitter, bitter cold that was out there and it was tough.

The great thing is that our customer seems to be very resilient because whenever we had nice open windows of weather warming up and snow melt, the customers were coming into the stores and they were coming in and they were buying. And so it kind of balanced itself out and I have heard a lot of the market news in retail about the weather and the impact that it has had, but I would have to say that as tough as it was weatherwise, I feel like the customer was resilient, they kept coming back and so we finished out our quarter.

January was very tough in the US. It was pretty flattish. The UK continued its strong momentum that it had through holiday throughout the rest of the quarter and throughout January and we have had -- this earnings announcement is a little later than the other three because of the year-end piece of it. So we have had the ability to see about half the quarter and Q1 has started off pretty well. We feel good about the guidance that we gave that you have seen and we feel good about meeting our objectives for the year.

On the advertising question, we did increase advertising a little bit last year. We did a little bit more continuity advertising and we extended it back into October a little bit. This year, we are looking at how to go about that. We are working with the networks and in fact, we have got our senior people in New York with some pre-meetings right now. We will have to see how they are able to negotiate things, but we are looking to try to add a little bit more flexibility into the way that we handle our advertising and we will have to see how that works out, but it will be another very strong advertising year. We are going to have some great campaigns out there and we are looking forward to a good year in fiscal 2015.

Eric Beder - *Brean Capital - Analyst*

Congratulations. Good luck for this good year.

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. In the UK, you had a strong holiday season and it looks like sales even accelerated in January. Is that acceleration continuing quarter to date and what do you think is driving that? Could you maybe discuss some of the macro environmental issues in the UK currently?

Mike Barnes - *Signet Jewelers Limited - CEO*

Yes, we did finish out the quarter very strong in the UK. January was very good. It continued the strong holiday performance. We have had a good start to the first quarter. We are not going to quantify that other than saying that, on a consolidated basis in the UK and in the US, it has been a good start. There are some timing shifts. The UK has a Mother's Day shift from week five to week nine. In fact, Mother's Day is going to be this Sunday in the UK. But everything seems to be moving along pretty much according to plan and we feel very good about being able to hit our objectives in this first quarter in the UK and the US and on a consolidated basis and we think that we have got a pretty good start to the new fiscal year. So we are pretty excited about it.

We have got a lot of things driving that UK business. They have been collaborating a lot with our US teams as well and I'll tell you our teams on both sides have just done a remarkable job. We have a lot of experience. We have got a new management team in the UK that has a tremendous enthusiasm. They have got a great culture driving the people. The storage teams are newly excited about driving the business there. They had a great holiday and kudos to them. They deserved it, they have worked really hard and they have done a fantastic job. They are driving their diamond business, they are driving their watch business. They are adding new and different promotions.

It is really an evolution of the jewelry industry in the UK I think that our team is trying to drive over there and I think they are doing a pretty darn good job of it. Now one great quarter is not a long-term trend, so I am not going to get overly excited about it. But you have to start a good long trend somewhere and I hope this is it, but we are going to be looking towards long-term consistent performance. That is really what matters is giving the best customer experience over a very long time period and watching your business grow and develop because of that. So they are doing a wonderful job with the merchandise, they are doing great with promotions, they are really driving the business and we look forward to the balance of the year.

Bill Armstrong - *CL King & Associates - Analyst*

Okay. Anything to call out in the UK in terms of either overall consumer spending trends or the competitive environment in jewelry? Anything going on there?

Mike Barnes - *Signet Jewelers Limited - CEO*

Yes, the competitive environment is tough as always. We have a lot of competition there in the jewelry business. And I think though that our team has positioned itself very well in that environment and that we are doing some new and exciting things to kind of change the dynamic of how competition works over there. The best compliment I can get, I think somebody told me the other day that one of the competitors said to them, you guys are not acting very gentlemanly over here. You are driving your business very strong. That is what I want to hear. So it is good and we are going to continue looking at new ways to drive the business and not just the same old things. But the macro environment seems to be getting slowly better. Hopefully, that will continue on and business for us so far has been pretty good and again, we look forward to the balance of the year.

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Bill Armstrong - *CL King & Associates - Analyst*

Okay, great. And just a real quick question for Ron. It looks like your CapEx this year will be roughly $30 million to $50 million higher than last year. It looks like about the same number of stores being open. What would explain the difference or the increase in CapEx this year?

Ron Ristau - *Signet Jewelers Limited - CFO*

Two primary things. Number one is just a shift from some IT projects that we were unable to complete in fiscal 2014, so the timing of them shifted out into 2015 and the second thing is the number of store remodels that we are doing is up somewhat in next year and those two things account really for the bulk of the differential.

Bill Armstrong - *CL King & Associates - Analyst*

Okay, great. Thank you very much.

Operator

Simeon Siegel, Nomura Securities.

Simeon Siegel - *Nomura Securities - Analyst*

Great, thanks. Good morning, guys. So Mike, I think you noted that Ultra drove 80 basis points of operating margin dilution to the US segment this year. Can you talk about the margin opportunities there this year as those conversions drive the improved productivity? And then, Ron, I believe you guys beat your intra-quarter gross margin expectations. Can you just talk about where the improvement fell between the commodity costs versus the promotional cadence and maybe the right way to think about those elements for the next few quarters? Thanks.

Ron Ristau - *Signet Jewelers Limited - CFO*

Okay. Well, when you get to Ultra -- as we said, Ultra last year -- as we came through the year, we came through with a negative EPS in the first quarter of $0.03, about $0.06 in the second quarter and about another $0.03 in the third quarter and then we started to turn slightly accretive as we had indicated in the fourth quarter as the business really started to gain traction. So I think the best way to think about it is that those numbers from last year will certainly not be repeated. We won't lose money in Ultra in any of the quarters, so that will be helpful and it is helpful in the first quarter. That is probably the best way to think about that just from an overall basis rather than break it down into what's in the margin or what's in the SG&A and everything else. I would look at it from a total EPS perspective.

And when we think about the margin and what improved in the fourth quarter, I mean the improvements were -- there was a little bit -- there were some in margin and there were some in SG&A versus our original expectation. Some of our SG&A savings had to do with actually some lower bonus calculation. So that is -- by the way, we'd like to have that happen, but that did happen versus our original expectation. And the movement is really almost too small to talk about of any substance. I would just say it got a little better in the margin as we came through January. Some of the promotions we are doing in December came off and therefore, the margins went up a little bit and we realized some benefit from that.

Simeon Siegel - *Nomura Securities - Analyst*

Okay. And then on the back of that going into I guess looking forward, is there a right way to think about it or any color helping with commodity costs and the impact that might have over the next few quarters?

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Ron Ristau - *Signet Jewelers Limited - CFO*

Sure. I think the commodity cost question, as we said last year, with our average costing system, the price improvements in gold, which started to occur in the first quarter of last year, we didn't realize that much of a benefit for it last year because it just takes time to wind through, so we will get a bigger benefit from gold commodity cost increases declining this year.

I will point out that there will be some offsets to that. Number one will be the fact that our scrap recovery rates -- when we sell gold on materials that we melt down, we will receive less money for that. Therefore that is an offset to the improvement in the average price of gold that we will see and we also are still dealing with the flowthrough on the commodity hedge losses that we incurred last year in the first quarter because we were hedged and when the prices unwound so rapidly, we took a fairly sizable hit. A piece of which went through last year's P&L and a piece of which will go through this year's P&L. That is about $19 million negative across the quarters and the whole year as disclosed in our 10-K.

But net-net, I would say that gold will be -- provided it behaves. This morning, it's down again. I don't know if anyone noticed, but it has went up to $1390. Today, it broke below $1300 again. So I think net-net it will be a helpful situation to us and I do not think that you should anticipate that margins will be down like they were in the fourth quarter. I think we will be able to get some more stability in our margin as we look into 2015. So we are relatively in good shape with that. I hope that answers your question.

Simeon Siegel - *Nomura Securities - Analyst*

That helps, so thank you very much and good luck for the year.

Ron Ristau - *Signet Jewelers Limited - CFO*

Thank you.

Operator

Rick Patel, Stephens.

Rick Patel - *Stephens Inc. - Analyst*

Hi, good morning, everyone and congrats on a strong year. Just a follow-up to an earlier question. The comp guidance for the first quarter looks pretty healthy in light of relatively difficult traffic trends at the mall. So how would you characterize it? Is it continued share gains in bridal? Have you raised prices so far in the new year? Has traffic come back? Just help us think about what you think will drive that comp.

Mike Barnes - *Signet Jewelers Limited - CEO*

Rick, you are right, traffic has been tough, but what we are seeing are -- we are seeing strong transactions and you mentioned bridal. That was very significant for us. We did see strong bridal growth. In fact, the mix increased likely there and fortunately bridal is a continuity business. People get engaged all throughout the year. Of course, at holidays sometimes it gets a little better even, but it is a strong business for every quarter of the year. So that is one of the reasons that we are so focused on being the best in bridal. But our fashion businesses have been good too. And I attribute that to the fact that we have got some exciting merchandise out there. Some of the new styles that we have got out there, some of the colored diamonds that we are selling out there, I mean they are just doing tremendously for us and our customers are looking for this new innovative type merchandise and they are coming into our stores.

So we have been beaten down a little bit with the lower traffic in the malls. We have been beaten down by Mother Nature in the weather, but the customers, as I mentioned earlier, they are just resilient and they just keep coming back and they are coming back because our teams are doing a

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fantastic job in the stores, because our corporate teams are doing an incredible job creating and innovating new and exciting merchandise and that is what is driving our business. That is really what it is all about.

Rick Patel - *Stephens Inc. - Analyst*

Great. And then can you talk about watches? It seems like that was an area of the store that did very well during the holiday season. What is your outlook for this business for this year and considering how well you are doing, is it an area that you would look to increase shelf space into or would that hurt your ability to drive the core jewelry business?

Mike Barnes - *Signet Jewelers Limited - CEO*

Watches have been a good category for us. They have been pretty strong. We have got a lot of brands that are doing very well. It is still a relatively small category for us. In the US, it accounts for about 7% of our business, but it is an important piece of the business because it does bring people and traffic into the stores. A lot of people are looking for specific watch brands when they come out shopping and that brings them into the stores and hopefully, we will end up selling them some diamonds, as well as watches when they do that. But it has been a strong part of the business. We continue to evolve that piece of the business too. We are continuing to look into certain higher-end fashion offerings. We have done pretty well by putting Michele into a decent number of Jared stores. We have also put Gucci out there. Gucci has tested very well. Coach is another fairly new brand for us that has tested well and we are looking at expanding some of these brands even further. So it is pretty exciting.

In the UK, watches have always been a big part of the business. It is about a third of our business in the UK, so it is very strong. A lot of that is attributable to the fact that, culturally in the UK, jewelry stores sell fashion watches whereas in the US generally they don't sell a lot of the midtier fashion watches. So we have had a very strong business in the UK with watches. Michael Kors, which everyone knows, is one of the hot brands out there is a brand that we carry for watches and jewelry in the UK and it was terrific for us. So we are excited about the partnership that we have with the major watch companies out there and we intend to build upon that even further.

We have a team at the largest watch show in the world right now. In fact, it started today, the Basel Watch Fair in Basel, Switzerland. And unfortunately, this is the first time I have missed that show in about 25 years, but I am glad to be here today given our great fourth-quarter results and talking about the great future that we have in front of us here.

Rick Patel - *Stephens Inc. - Analyst*

We are glad you are with us. Thanks very much and good luck this year.

Operator

Oliver Chen, Citigroup.

Nancy Hilliker - *Citigroup - Analyst*

Hi, everyone, thanks so much. This is Nancy Hilliker filling in for Oliver Chen. Congratulations on the quarter. We wanted to ask a little bit more about the strong performance in the branded merchandise. At 31.1%, do you expect that to go higher? Are there particular new launches that you would expect to continue to drive that higher? And then just a follow-up in terms of Mother's Day, is there any US-based calendar shift that we should know about?

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Ron Ristau - *Signet Jewelers Limited - CFO*

I will start with the -- from a calendar shift perspective, no, there is nothing that is significant. Easter flips back into April, of course, but Easter is not a big driver of jewelry sales. It is somewhat helpful, but it is just a switch between March and April, so it is within the quarter. So nothing that you would or should be concerned about and Mother's Day is placed almost exactly where it was last year, so the timing of our programs will be the same. Could you just repeat the first part briefly? What was the first part of your question?

Nancy Hilliker - *Citigroup - Analyst*

Sure. Brand penetration in terms of (multiple speakers).

Ron Ristau - *Signet Jewelers Limited - CFO*

Oh, why we are up on brand penetration. It has to do with the colored diamonds. Mike?

Mike Barnes - *Signet Jewelers Limited - CEO*

Yes, we have got some new brands in our differentiated lineup. Vivid diamonds, which are a range of colored diamonds that we carry in Jared and Artistry diamonds, which is a line of colored diamonds that we carry in Kay and they have just done extremely well. As I mentioned earlier, the customer is looking for very fashionable new merchandise. The colored diamonds are doing well. We have also got other merchandise categories within the diamond range. We have got a new line called Diamonds in Rhythm that was very strong for us during holiday and again during the important Valentine's Day holiday period and the big brand names continue to drive more volume and strong growth.

The Neil Lanes are doing fantastic; Tolkowsky diamonds doing very, very well. Some of the important fashion programs -- I mentioned in my prepared remarks, Jane Seymour continues to be an important part of our lineup, as does Neil Lane Designs, which is the fashion piece of that. And it is just very strong. Our team is getting better and better at the branding. We are going to continue driving that and we are going to continue looking for new things to test and we will see how it goes, but we are pretty excited about the lineup we have got.

Ron Ristau - *Signet Jewelers Limited - CFO*

Just a small point of clarification. Diamonds in Rhythm is not part of our branded proprietary group, just to (multiple speakers).

Mike Barnes - *Signet Jewelers Limited - CEO*

No, (multiple speakers) it was just a strong brand.

Ron Ristau - *Signet Jewelers Limited - CFO*

It's a great brand, but it just isn't -- yes, it's just not in our -- I don't want to confuse anybody.

Nancy Hilliker - *Citigroup - Analyst*

Thanks so much.

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Mike Barnes - *Signet Jewelers Limited - CEO*

You are welcome.

Operator

Brian Tunick, JPMorgan.

Bedham Boyna - *JPMorgan Chase - Analyst*

Hi, good morning. Thanks for taking my question. This is [Bedham Boyna] filling in for Brian. I guess going back to the UK, I was wondering if a significant portion of your turnaround initiatives are done and finally bearing fruit at this point? I guess more specifically in terms of the three points you laid out last year, the merchandise, real estate and expense management buckets. Where would you say we are with those at this point?

Ron Ristau - *Signet Jewelers Limited - CFO*

I think that we are doing great. All those three initiatives are seen and reflected in the UK results. Obviously, we have made significant strides in the merchandise and what is being presented and things that we are stressing there with our reemphasis on bridal and diamond and some of the renovation that we have done in the watch category, particularly the launch of Michael Kors into that brand has done well. So that addresses the first part.

The real estate closing and renegotiating importantly of rents is continuing very strongly to contribute to financial results there and we continue to reduce costs as evidenced by the results in the SG&A area. We did save some pretty good money. We did do some redeploying of that money into areas that drive sales. So we instituted some new bonus programs in the UK that are more similar to the US and we also spent some additional money on advertising and you see that reflected in the comp.

So we have been moving money into more productive areas as we save on some of the areas where we wanted to cut costs. So I would say that program is a direct result of everything that we have done. That combined with our new management team and the partnership that Mike mentioned with the US, all of it is working together to drive that business forward.

Bedham Boyna - *JPMorgan Chase - Analyst*

Great, that's very helpful. And then on the gross margin side, I guess going back to Simeon's earlier question, I was wondering how we should think about it between the tailwind you should get from the lower commodity costs and the impact of gold hedges. I know the P&L impact here is sales-dependent, but maybe can you provide a little more color relative to last year where your blended input costs are and where your gold hedges are?

Ron Ristau - *Signet Jewelers Limited - CFO*

Well, what I would tell you is that the reason I made the comment in three parts is that last year we saw de minimis impact on our average gold cost. We will see greater impacts in fiscal 2015. However, the total impact on the Company will be mitigated somewhat by what happens in the gold scrap cost area and of course, we are dealing with those hedge losses of $19 million, which are one-time in nature. Obviously, we hope that that doesn't happen again, but we are dealing with it this year, so it will be a slight offset to the benefits that we get. The net message I guess I would try to give you is that gold will be helpful, but I would stay balanced in your thinking about how much it would improve because of the two offsets that we have.

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Bedham Boyna - *JPMorgan Chase - Analyst*

Great, thank you very much and best of luck.

Ron Ristau - *Signet Jewelers Limited - CFO*

So I would say -- I hope that is helpful.

Operator

Ike Boruchow, Sterne Agee.

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

Hi, everyone, good morning and congrats on a solid year. I guess, Ron, I wanted to ask you about the credit portfolio right now. How do you feel about the book today and then how should we be thinking about credit participation in 2014 and also receivable book growth as we model out 2014?

Ron Ristau - *Signet Jewelers Limited - CFO*

Sure, that's a very good question. Well, the credit portfolio, as I indicated, continues to perform very strongly. We are very pleased with the overall performance of the portfolio. We have experienced last year some creeping increase in the participation and penetration rates because people just seem to like the program and the certainty of payments and they like to pay off their jewelry purchases quickly, which is what we always say is the benefit of our program. So I would expect that this year when you think about it that we will probably see some slow further increase in the penetration rate, nothing dramatic, but slow increase driven by our focus on bridal. Again, as you know, credit supports the bridal program very, very strongly and as high as 70% and maybe even a little higher as it keeps getting up there. So it is a very important part of supporting our bridal program, so that will drive it forward.

And I think that the overall performance of the portfolio will remain stable, which I would describe as good to excellent. I mean it might get some creeping increase in the bad debt as a percentage of sales again due to growth in the overall portfolio. Last year on an annual basis the growth in the portfolio should be I would guess somewhat similar, maybe a touch lower, but similar is the way to model it is what I would choose to do. And if the business gets stronger, it might go up a little bit, which would be a good thing. If the business is relatively consistent with last year, it would be about the same growth rate. I think that is how you should think about it. But the performance of that portfolio is very, very strong.

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

Okay, great. And then, Ron, also when you talked about kind of putting together the new capital structure of the Company, you mentioned certain things you are trying to optimize and one of the things I think you mentioned was the tax rate. I am just kind of curious when you think about your tax rate today, 35%, some of the things, levers you are pulling right now, where do you think that could ultimately go directionally?

Ron Ristau - *Signet Jewelers Limited - CFO*

I think it would be -- we don't target tax rates, so I don't know. We try to put in place very effective programs and as we develop our programs and complete the acquisition of Zales and put in place our new financial structure, which we do expect to be efficient from both a financing and tax perspective, we will be happy to provide more information about that. But I think any speculation would be premature at this point and I think that is where I would leave it for now. We hope it will get better, but we will not be able to target exactly how much. Everything we are doing

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relative to the financing we believe should create substantial value for shareholders and owners of the Company. So we have that in mind as we do all this and we will put in place a very excellent package, I can assure you. I'm sorry I can't be more specific. I just don't think it is wise to do so.

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

That's great. Thanks so much and I am also happy you are all here.

Operator

David Wu, Telsey Advisory Group.

David Wu - *Telsey Advisory Group - Analyst*

Thanks. Hi, good morning, everyone and congrats on the very solid quarter. My first question, can you comment on what you are seeing in the promotional landscape and your expectations for this year and if you have pulled back on some of your promotional strategies since the holiday season?

Mike Barnes - *Signet Jewelers Limited - CEO*

We are continuing with I would say fairly consistent promotions as we do year over year. I haven't seen anything remarkably different in the landscape out there. Things seem to be pretty much status quo. We continue to, as we always do, test a few new promotions here and there and see how they work out, but I wouldn't expect anything dramatically different this year promotionally than what we saw last year, at least not in the environment that I am seeing out there today.

David Wu - *Telsey Advisory Group - Analyst*

Got it. So we shouldn't see any incremental promotions relative to last year, it should be about the same?

Mike Barnes - *Signet Jewelers Limited - CEO*

I think it is going to be relatively similar to last year at this point.

David Wu - *Telsey Advisory Group - Analyst*

Excellent. And how did the gross merchandise margin perform in both the US, as well as the UK in the quarter?

Ron Ristau - *Signet Jewelers Limited - CFO*

The gross merchandise margin? I believe we have addressed overall the merchandise margin at the margin level, not the gross merchandise margin level, which we are trying to back away from for a lot of different reasons. So the main driver of what happens at the margin level is the gross merchandise margin, so that is how I think you should think about that.

David Wu - *Telsey Advisory Group - Analyst*

Got it, but directionally it improved or contracted in the quarter?

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Ron Ristau - *Signet Jewelers Limited - CFO*

No, no. I'm sorry. In our comments, in my prepared comments, I said in the fourth quarter of the year, the gross margin, okay, in the United States declined by approximately 70 basis points and the gross margin in the UK improved by 70 basis points. I would tell you that the primary driver of that is gross merchandise margin without being specific.

David Wu - *Telsey Advisory Group - Analyst*

Got it, great. And can you provide any details on perhaps some of the new exclusive product launches that you are currently testing?

Mike Barnes - *Signet Jewelers Limited - CEO*

Yes, this is that time of year, David, when we are doing tests and we don't really get into a lot of detail because we want to see how they work out and at the appropriate time in the year, we will talk about what it is, but I would like to get them into the stores before I announce that to my competitors out there what I'm working on.

David Wu - *Telsey Advisory Group - Analyst*

Great. And if we continue to see healthy momentum in the UK, does this perhaps speed up the timing of when you can reach a double-digit op margin there?

Mike Barnes - *Signet Jewelers Limited - CEO*

We have not put an exact timing on that and we don't think it is prudent to do that, but we do feel like we have turned a corner and that we are making the steps in the right direction now. So we will see how it goes. Again, we had one really great quarter and kudos to the team there. I am really proud of them, but we need to see a little bit more consistency. So we will watch it very closely this year and see how it goes. We have had a reasonably good start I believe in both the UK and the US as we move into the new fiscal year and we will see how it turns out, but we are pretty excited about it.

David Wu - *Telsey Advisory Group - Analyst*

Excellent. And then just lastly, how many stores are you planning to close in the US and UK this year?

Ron Ristau - *Signet Jewelers Limited - CFO*

In fiscal 2015?

David Wu - *Telsey Advisory Group - Analyst*

Correct.

Ron Ristau - *Signet Jewelers Limited - CFO*

This year, this year. Okay. The numbers will be -- it always moves around. I am always reluctant to give a number because it is highly dependent upon what kind of alternatives we get to when we get to the final negotiations with landlords often. And last year, the numbers were inflated by

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Ultra, by 15 closures in Ultra and we did about 16 in the regional area. As we said, the regionals are -- right now, we are still under closure. We will see what happens when we get a chance to take a total look at our real estate portfolio with the inclusion of the Zales properties and so on. So there could be some change in direction there.

I would tell you that thinking of 50-ish stores is a reasonably safe number because there's always a culling that goes on relative to stores that, in the normal course of business, we just will not renew. For instance, last year, we did not renew 22 Kay stores out of 1000. So there's always some percentage that you are going to say this isn't going to work any longer and it is healthy I believe to be culling out those bottom performing stores. I think that is a sign of a very healthy retailer. So I would give you a nice round number of 50-ish as an estimate.

David Wu - *Telsey Advisory Group - Analyst*

And this is total, including both the US and the UK?

Ron Ristau - *Signet Jewelers Limited - CFO*

Well, you are asking for a specific number now. I am saying 50-ish is a reasonable number to use in planning and any number that is different than that wouldn't have a material impact on models one way or another I would guess.

David Wu - *Telsey Advisory Group - Analyst*

Excellent. Thank you very much.

Ron Ristau - *Signet Jewelers Limited - CFO*

Thank you.

Operator

Andrew Hughes, UBS.

Andrew Hughes - *UBS - Analyst*

Good afternoon. Nice to be coming from the UK and asking a question when the UK site performs better than the US for once. It's not often that's the case. I just had a follow-up question on the credit side, your slide 19 on net impacts. I think you were suggesting from the previous answer that you would expect that net impact to increase. Would there be any conditions under which it actually might fall, that net benefit in the current year?

Ron Ristau - *Signet Jewelers Limited - CFO*

Nothing that I can foresee would tell me that it would be substantially under stress or that it would fall in any way. I believe that the receivable portfolio will grow slowly and that the customers seem to continue to be shifting to the regular terms versus the interest-free terms. That increases the other operating income, so I would expect to see some slight improvement in that as we go forward. And I think the bad debt is performing well. So I have nothing on my radar screen that tells me that there would be a -- that I am concerned in any way at this point in time.

The only things that we are going to have to worry about on something like this is a huge -- the only time we have ever had a problem with it over the last 10, 15 years has been the financial crisis in 2008, which was a huge (inaudible) event. I don't know of anything like that on the horizon and

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that is the only thing that could change that. But that is a very unusual circumstance. Nothing that we foresee tells us that that is going to happen. These numbers are relatively stable numbers.

Andrew Hughes - *UBS - Analyst*

All right. Where are we in terms of percentage of regular credit versus the interest-free credit? Where are we now?

Ron Ristau - *Signet Jewelers Limited - CFO*

We don't generally quote that number publicly for competitive reasons.

Andrew Hughes - *UBS - Analyst*

Or even relative to history?

Ron Ristau - *Signet Jewelers Limited - CFO*

Well, on a relative basis, I mean against the size of the portfolio, it's a relatively stable number. When it moves, it moves in basis points and we see it and we know it is happening, but it is not like it moves 500 basis points in a year. It moves 30 basis points, 40 basis points, something like that. So it is a small movement in accretion towards the regular terms, nothing dramatic.

Andrew Hughes - *UBS - Analyst*

Right. Okay, good. Okay, thank you for that.

Operator

Thank you. I will now turn the call back to Mr. Barnes. Please go ahead.

Mike Barnes - *Signet Jewelers Limited - CEO*

Thank you so much and thank you all for taking part in the call. We really appreciate your interest and your support. Our next scheduled call is on Thursday, May 22 and that is when we will review our first-quarter results. I hope you all have a great day and look forward to our next meeting. Thank you.

Operator

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

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