Signet Jewelers Limited
Fiscal 2015 Fourth Quarter and Full Year Financial Results Conference Call
March 26, 2015

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the Signet Jewelers Fiscal 2015 Fourth Quarter and Full Year Financial Results conference call and webcast. During the call, all participants will be in a listen-only mode. After the presentation, we will conduct a question and answer session. Instructions will be provided at that time. If at any time during the conference you need to reach an Operator, please press star, followed by zero. Please note that this call is being recorded today, March 26th, 2015, at 8:30 a.m. Eastern Time.

I would now like to turn the meeting over to your host for today's call, James Grant, Vice President of Investor Relations. Please go ahead, James.

James Grant:

Good morning and welcome to our Fourth Quarter Fiscal 2015 Earnings call. On our call today are Mark Light, CEO, and Michele Santana, CFO. The presentation deck we will be referencing is available under the Investors 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 will be filed today with the SEC. We also draw your attention to slide number 2 in today's presentation for additional information about forward-looking statements and non-GAAP measures.

Now I will turn the call over to Mark.

Mark Light:

Thanks, James, and good morning, everyone. In the fourth quarter, we delivered solid top line and bottom line results. Signet comp store sales increased by 4.2%, with strong sales performance across all divisions and selling channels. On a divisional basis, Sterling delivered a same-store sales increase of 3.7% while delivering record operating profit. Zale drove an impressive 3.7% comp sales increase. Our UK division delivered its highest fourth quarter of same-store sales increase in 13 years, at 7.5%, and its best operating profit in three years.

From a merchandise view, Signet's Bridal and Fashion Diamonds performed very well

across the organization, and by selling channel, our broad-based strength was evident with outlets and eCommerce delivering strong results, in addition to our traditional store locations. Signet's eCommerce sales in the fourth quarter were $149.6 million, which was an increase of 89.4%, which was due to the addition of Zale this year, but when you exclude Zale division, our eCommerce sales were at $94.8 million, which was at a growth rate of 20%.

Signet's fourth quarter adjusted EPS was at $3.06, a penny higher than our top end of our guidance and up 40.4% from the prior year period due to strong execution of our fourth quarter strategies. I would also like to add that Zale favorably impacted EPS by $0.43, so when measured on an apples-to-apples basis versus last year by excluding Zale, Signet's EPS was up $0.35 or 16.1%.

Now let's focus on our performance by division, starting with the Sterling division. We had a variety of drivers behind our fourth quarter Sterling results, most notably our sustainable competitive strengths that include our superior guest experience, our exciting merchandise offerings, our creative marketing and our multi-channel approach. The customer experience is central to our success and we were very pleased with our service metrics that was delivered by our store teams in the fourth quarter and for the year. As for merchandise, Sterling's the fourth quarter results were driven by our entire bridal category, as well as fashion jewellery, especially Le Vian and Diamond in Rhythm.

Marketing also played a crucial role in the fourth quarter, with the benefits of new creative, increased impressions and well-placed media. Growth in eCommerce and outlets exceeded the division average, while malls and freestanding stores performed well also. All this led to same-store sales increase of 3.7% in Sterling and, as I said earlier, record operating profit.

Now moving on to our Zale division. Zale delivered a strong fourth quarter through the variety of planned investments and initiatives around merchandising, marketing and field operations. Let's begin with merchandising. Our branded bridal and fashion diamond collection performed very well, led by the Vera Wang Love collection, our Celebration Diamond collection and our Unstoppable Love. We've been focused on expanding depth versus breadth in the Zale merchandise assortment, and this proved effective in the fourth quarter. We believe we have significant potential to continue to grow our brands, along with developing new brands through our innovation process.

As for marketing, we increased our TV and online media investment, we strengthened the quality and the placement of our marketing, we focused on Vera and it all worked. We directed more resources towards the flagship Zale's brand in the US and People's brands in Canada and heavily supported their in-store events. Our store teams focused their presentations on features and benefits of our offerings, especially in the context of

bridal and the Vera Wang Love collection. We also increased payroll for appropriate floor coverage and provided new incentives.

In the fourth quarter, there were a variety of successes in the Zale division. We delivered strong results in Canada in spite of the weaker energy industry, and the Piercing Pagoda and eCommerce businesses performed well. We saw a lot of terrific collaboration between the Zale, Sterling and UK teams to enhance our synergies going forward.

As a result of the acquisition, Signet will realize significant operating profit synergies. We've talked about this before and there are no changes, but it bears repeating where these synergies will come from and how they will flow and why. Of the $150 to $175 million of net synergies, roughly 20% will be achieved from expense reductions, 30% from repair services and brand cross-selling and 50% from supply chain and purchasing initiatives. Now as shown on the right graph of Slide 6, we expect to see about 20% of the $150 to $175 million achieved by fiscal year-end 2016, mainly in the second half of this year. By the end of fiscal 2017, another 40% of synergies will be achieved for a total of 60% of our three-year goal. Then by the end of fiscal 2018, we expect to achieve the final 40% of our synergy goals. We believe the cadence of the synergies will flow in these proportions due to the reinvesting of some growth synergies and the time required to deploy and effectively utilize certain information technology. One final point on synergies; the majority of the operating profit synergies will be achieved within the Zale division, but not all of it. A minority of synergies will fall in the Sterling and UK divisions.

In the UK, we delivered our best fourth quarter comp sales in 13 years and our best operating profit in three years. The same drivers that we have seen in the first three quarters of the year once again led the division's improved results. These included initiatives around diamonds and an omnichannel approach, new marketing and a focus on sales rather than task. The UK results were driven principally by the benefits of strategic moves we've taken around diamonds based upon a better understanding of our customers and the types of products, pricing and promotions that they require. Store team member training is more focused on diamonds, which by the way helps all sales training. Point-of-purchase plays are more powerful, more space has been devoted to diamonds. Bridal diamond brands performed very well, such as Perfect Fit and Forever Diamonds in our H. Samuel stores and Leo, Neil Lane, Le Vian and Tolkowsky in our Ernest Jones stores, and new TV advertising creative with increased impressions has also driven our diamond business.

Our redesigned H. Samuel and Ernest Jones websites as well as improved fulfillment processes, strengthened our UK income results. In addition, we opened our first eight Ernest Jones outlet collection stores in the United Kingdom, and we are pleased with their start and intend to open up more this year and into the future. We have made a

variety of store operation improvements that are driving better sales productivity. In general, the focus on the field operation teams has shifted considerably more in favor of engaging customers and selling as opposed to non-customer facing tasks.

It was an absolutely incredible year for Signet, and I now want to take a moment to review just some of the more notable accomplishments in fiscal 2015. The acquisition of Zale was the most significant M&A transaction in the history of jewelry retail. Rarely in retail does number one acquire number two and still have significant runway for opportunity because of the highly fragmented nature of our marketplace. Our UK performance was unprecedented, as I detailed moments ago. We have made great strides in establishing a highly collaborative, team-oriented mindset within and between all three of our divisions. We have also begun to establish the ongoing process of sharing best practices and using them within all of our divisions. We call this being Signetized.

We continue to find additional ways to unlock the value in our outlet channel. In fiscal 2015, we rolled out Jared Vault and we opened new Ernest Jones outlet collection stores in the United Kingdom. We became more vertically integrated to secure supplies of diamonds for all of our stores globally, and one of the crowning achievements was becoming a DeBeers sightholder. We grew our proprietary and exclusive brand penetration by successfully testing and extending compelling merchandise collections, and we continue to innovate and develop new product with the opening of Signet's new design center in New York.

We believe more strongly now than ever that an omnichannel approach to jewelry retail is critical. We educated our customers, we communicated with them and merchandised to them through an internet, not only to drive eCommerce growth but also to maximize in-store experiences. We strengthened our digital ecosystem experience by optimizing store brand websites for both desktop and mobile devices, by increasing merchandise assortments and by investing in social media. From a financial performance perspective, we hit or exceeded all of our financial metrics, including or excluding Zale. We returned value to shareholders by increasing our dividend for the third year in a row while integrating a major acquisition, and all of this led to an important threshold of over $10 billion in market capitalization.

With that, I'll now turn over to Michele for a look at our financials.

Michele Santana:

Thanks, Mark, and good morning, everyone. I'll apologize in advance; I'm battling a cold so if I interrupt my commentary with an occasional cough, again I apologize.

All right, so to start with, I just want to emphasize my comparison and commentary will be focused on our fourth quarter results. So let's begin by reviewing sales, which Mark offered a brief overview of these numbers a few moments ago. In the Sterling division, total sales increased by 0.5% to$1,358.3 million, which included a same-store sales increase of 3.7%. The average transaction price in Sterling increased by 4.5% and the number of transactions decreased by 1.2%. The increase in the average transaction price was driven primarily by bridal and diamond, with a number of transactions impacted by a decline in sales associated with lower average selling priced units. Zale's division total sales were $636.7 million for the quarter, which included a same-store sales increase of 3.7%. Total sales also included a $12.8 million unfavorable revenue impact due to purchase accounting adjustments related to deferred revenue. As Mark indicated, sales were driven in part by initial synergy initiatives surrounding sales associate training, merchandise assortment and new marketing creative. Merchandise sales were particularly strong in branded bridal and branded diamond fashion.

UK division total sales increased 2.1%, or 7.7% on a constant exchange basis, to $278 million, with a comp sales increase of 7.5%. This increase was driven primarily by branded bridal, fashion diamond jewelry and fashion watches. The average transaction price increased by 7% and the number of transactions increased by 1.6%, and that was attributed to strong performance across the entire merchandise portfolio.

Moving on over the next couple of slides, I will share with you Signet's consolidated Q4 performance before we turn and analyze Signet's adjusted results. So on Slide 10, the table provides a reconciliation of Signet's adjusted results to consolidated results. Again, the difference between adjusted Signet and Signet are the columns reflecting purchase accounting and transaction cost, which also include integration-related expenses. On a GAAP basis, EPS was $2.84 per share and that was $0.01 higher than our guidance. Purchase accounting adjustments, which include a reduction to deferred revenue, amortization related to inventory fair value step-up and amortization of unfavorable contracts, were diluted to EPS by $0.14. Transaction costs, including advisory, accounting and integration costs, were responsible for $0.08 of dilution. Signet's effective tax rate for the quarter was 29.6% and the effective tax rate for fiscal 2015 was 29.5%.

So let's now look at the breakdown of operating income by division. Operating income of $331.7 million or 14.6% of sales consisted of the following components: Sterling Jewelers' operating income was a record $260 million or 19.1% of division sales, and that is up 140 basis points from last year. Zale division operating income was $36.1 million or 5.7% of division sales. Zale's performance consisted of $32.8 million in profit from Zale's jewelry operating segment and $3.3 million from the Piercing Pagoda operating segment. Now, that does include cost of $20.8 million related to purchase accounting adjustments which we just discussed on the previous slide. Excluding the

impact from these accounting adjustments, the Zale division operating profit was $56.9 million or 8.7% of division sales.

The UK operating profit was $53.8 million or 19.4% of division sales, and that is $2.1 million higher than last year and was the best Q4 operating performance in three years. This performance is attributed to a continued focus on growing top line, combined with cost control measurements. Other primarily consists of our corporate and administrative expenses and Signet's diamond sourcing subsidiaries. It also included $9.2 million of transaction cost.

To help provide comparability to last year, we are also presenting our results on an adjusted basis, which excludes the purchase accounting adjustments and transaction costs. The presentation here on Slide 12 takes adjusted Signet, which is shown on the far right side of the slide, and then breaks it into two parts. One part is Zale operations, which is reflected in the middle column, and the second part in the left-hand column is adjusted Signet excluding Zale. Adjusted Signet excluding Zale is the rest of Signet, inclusive of our finance, interest and taxes. From sales to operating income, this gives you an apples-to-apples comparability to prior year results. In addition, the information is provided to give you visibility as to how the Zale operations performed in the fourth quarter.

Now, recall that we had guided for the Zale EPS accretion of $0.36 to $0.40 for the fourth quarter. Our actual accretion for Zale operations was $0.43, resulting from higher margins and lower expenses in the quarter. We anticipate providing this incremental detail for you until we establish precedent for Signet's results post acquisition when we lap these numbers in the third quarter.

So continuing on, let's review Signet's adjusted P&L results below the sales line. Adjusted gross margin was $936.9 million or 40.9% of adjusted sales, and that was down 60 basis points versus last year. The decrease in rate was driven by the addition of Zale, which impacted the gross margin rate by 110 basis points. Now, excluding the Zale division, the adjusted Signet gross margin rate would have been 42%, and that compares to prior year fourth quarter rate of 41.5%. The Signet adjusted gross margin rate decrease of 60 basis points was partially offset by a higher gross margin rate in the Sterling division of 70 basis points, primarily due to merchandise margin factors, including lower commodity costs.

Adjusted SG&A was $629.3 million or 27.5% of adjusted sales, and that was up 30 basis points versus last year. This increase again was driven by the addition of Zale, which impacted the rate by 70 basis points. Excluding the Zale division, the adjusted Signet SG&A rate would have been 26.8%, and that compares to the prior year SG&A rate of 27.2%, with SG&A leveraging on higher sales.

Other operating income was $54.1 million. This increase of $6.5 million was due

principally to higher interest income earned from higher outstanding receivable balances. Adjusted operating income in the fourth quarter was $361.7 million or 15.8% of adjusted sales. Excluding the Zale division, the adjusted Signet operating margin would have been 18.6% and that's up 130 basis points from prior year operating margin rate of 17.3%.

Adjusted EPS was $3.06 compared to $2.18 in the fourth quarter of fiscal 2014. On a comparable basis, that is when excluding this year's impact from the newly-acquired Zale and the capital structure and financing, EPS was $2.53 or a 16.1% increase over last year.

So let's move on to the balance sheet and we'll begin with reviewing our inventories level. Net inventory ended the year at $2.4 billion, and that's an increase of nearly $1 billion or 63.9% over last year. The increase was driven almost entirely by the acquisition of Zale. Now, to a lesser extent, inventory levels were also impacted by the Sterling Jewelers division, which increased approximately 4%, and this increase was primarily due to new store growth, as well as modest increases among branded bridal and diamond jewelry collections, as well as loose diamonds. Due in part to our strong January, our inventory levels and assortment are well positioned in the first quarter.

So moving on, we'll turn our attention to our in-house credit metrics and statistics. In-house credit remains an important component of our Sterling division's business and a competitive advantage. Net accounts receivable increased to $1.57 billion compared to $1.37 billion last year, up 14.1% and that's driven by higher sales, as well as an increase in the credit penetration rate. Our credit participation was 60.5% compared to 57.7% last year. The increase in credit participation is attributed primarily to our credit decision engine improvements made in April of last year, as well as higher outlet credit participation and strong guest acceptance of our credit offerings. The average monthly collection rate year-to-date was 11.9% compared to 12.1% last year, as guests continued to opt more to our regular credit terms which requires lower monthly payments as opposed to the 12-month interest-free program.

So moving on to credit statistics around our in-house finance programs. Net bad debt expense for the year was $160 million compared to $138.3 million last year, an increase of $21.7 million, and that was driven primarily by the growth in our receivable balance from increased credit participation and change in the credit program mix. Interest income from our in-house program, which makes up the vast majority of our other operating income P&L line item, was $217.9 million, and that compares to $186.4 million last year. This was an increase of $31.5 million and is due primarily to more interest income on the higher outstanding receivables, as well as the shift away from the interest-free programs. So the net impact of these two items was income of $57.9 million compared to $48.1 million in the prior year or an increase of $9.8 million.

Operating improvements made to our decision engine have helped increase credit penetration and profit without adversely affecting the net impact of our bad debt for the full year. So on a quarterly basis, the net impact of bad debt and interest income was about flat, and that's due primarily to the timing of recoveries which have been realized in the first quarter of fiscal 2016. The portfolio continues to perform very strongly for us, and that's evidenced by the allowance as a percentage of our ending accounts receivable finishing nearly flat to last year.

So let's move on to some other highlights of the balance sheet. All right, capital allocation. In terms of Signet's capital, I am really excited to share with you our priorities for capital structure and our capital allocation strategy which have been thoughtfully developed. We have a strong balance sheet and this will allow us to execute our strategic priorities, invest in the business and return excess cash to our shareholders, all while ensuring adequate liquidity. We are proud to have an investment grade rating and we're also committed to maintaining these ratings, and this is important to us because long term, we will continue to invest in the organic growth of our powerful store brands, as well as pursue value enhancing acquisitions. Our focus remains growing on a per-share basis.

Among the key tenets of our capital strategy that we would like to share with you, are to achieve an adjusted leverage ratio at or below 3.5 times. Now, we ended fiscal 2015 at 4 times but keep in mind that this only includes a partial year of Zale, so as our business grows in fiscal 2016, we should start fiscal 2017 with a ratio closer to our target which will allow us to utilize our balance sheet in fiscal 2017 and beyond with available sources of debt. We plan to distribute 70% to 80% of annual free cash flow in the form of stock repurchases or dividends, assuming no other strategic uses of capital. We expect to increase the dividend consistently, which we have been doing over the last several years.

Now, in terms of share repurchases, we will repurchase $100 million to $150 million of Signet's stock by the end of fiscal 2016. We have a remaining authorization of $265.6 million, and as this program runs out, we will review and initiate a new program with our Board, in line with leverage and free cash flow targets. Finally, we will evaluate using additional capacity beyond our current $600 million on the asset-backed securitization facility beginning in fiscal 2017.

So now, I'd like to just take a quick minute and walk through the calculation behind our adjusted leverage ratio, which is outlined on slide 18. Our methodology of calculating our leverage ratio is really closely aligned to our more constraining credit rating agency approach and incorporates a captive finance adjustment. Now, this adjustment reduces Signet's total debt, inclusive of ABS debt, by 70% of finance receivables and excludes finance income from our EBITDAR.

So if we walk through the calculation and we'll start at the top of the slide with our captive finance adjustment. This adjustment is simply our net Sterling Jewelers division refinance receivables time 70%, and as you can see in a few rows down, this amount of $1,087 million will reduce Signet's total adjusted debt. So in the second row on the slide, we add long-term debt, which includes our asset-backed securitization and loans and overdrafts, to derive at our total balance sheet debt. To then arrive at Signet's adjusted debt, we add our balance sheet debt and 8 times rent expense, and from this, we subtract the captive finance figure calculated on the first row. This sums to adjusted debt of $4.1 billion. The denominator, or our adjusted EBITDAR on the fourth row, is calculated by summing our adjusted EBITDA, rent expense and share-based compensation, and from this, we subtract our finance income from our finance receivables. This comes to an adjusted EBITDAR of just over $1 billion. With a full year of Zale operations and our expected growth in fiscal 2016, we will be well positioned to evaluate utilizing additional capacity under our ABS facility in fiscal 2017. Our capital allocation policy allows for continued growth in the business, coupled with meaningful returns to our shareholders.

So now we'll move on to our financial guidance. First quarter Signet comparable store sales are expected to increase 3% to 4%. First quarter adjusted EPS is expected to be $1.57 to $1.62, and as a reminder, adjusted EPS is EPS less the two sets of adjustments shown on Slide 19, being purchase accounting and transaction cost. Now, within adjusted EPS, Zale operations are expected to be accretive in the first quarter by $0.17 to $0.18.

I would also add, only because it's been a hot topic in our space lately, that the impact of EPS from (inaudible) tax is expected to be minimal, and I would just remind you that less than 10% of our annual operating profit is earned outside the US. From an effective tax rate standpoint, Signet's fiscal 2016 annual rate is anticipated to be 28% to 29%, and the difference versus our fiscal 2015 is principally the full year effect of owning Zale and having our capital structure in place. Capital expenditure guidance for the full year is $275 million to $325 million, and net selling square footage is projected to grow approximately 2% to 3%. So I'd also reference you to our earnings release for further detail by division.

That concludes my prepared remarks on the financials, and with that, I'll turn the call back over to Mark.

Mark Light:

Thank you, Michele. In conclusion, I want to sincerely congratulate and thank all of our Signet team members for a fantastic fiscal year and fourth quarter. Their dedication,

their passion and their collaboration delivered significant value for Signet shareholders and positions us for growth into the future.

Now, we'll take some time for your questions.

Operator:

At this time, those with questions should lift their phone receiver and press star, followed by the number one on their telephone keypad. To cancel a question, please press the number sign. Please hold a brief moment while we compile the Q&A roster.

Your first question comes from the line of Simeon Siegel from Nomura. Your line is open.

Simeon Siegel:

Thanks. Good morning, guys, and congrats on a strong finish to a great year.

Mark Light:

Thank you, Simeon.

Simeon Siegel:

So comps accelerated through January. Was that just lapping into your compares, or can you talk about anything you may have done differently? Did you re-emphasize any marketing (inaudible) of the brands, et cetera? Then you guys ended Zale's, the stores I think above the initial guidance and you're guiding flat for the year. Can you talk about what you've seen over the past few quarters that's maybe shaping your opening Zale's store account objectives? Where do those 30 to 35 Zale's division openings fall within the concepts? Then just lastly, Michele, so the Zale EBIT margin contracted slightly this quarter but I think better than initially expected. What's the implied EBIT assumed within that $0.17 to $0.18 for Q1? Thanks.

Mark Light:

Thanks, Simeon, and thank you for your kind words. So by reference to the January comps, we mentioned this, if you recall, during our holiday announcement in January, that our January started off good, and we also mentioned that our bridal business and our strategy, our best in bridal strategy continues to be doing very, very well and it carried through January and it continues to carry through our business. So we didn't make any major changes other than what we shared in the holiday conference call, is that bridal becomes a bigger part of our business in January and carries on through the

year, and some of the items that weren't doing as well continued to trend and the run rate on some of the lower-priced items; that trend rate has returned to a positive. We're getting into more positive momentum.

In reference to the Zale openings, we're actually very excited about the opportunity to grow the Zale brand. If you look at our portfolio today, the Kay brand has—or the Kay store brands have well over a thousand stores and Zale's in the 700 zone, and we think there's tremendous opportunity to continue to grow the Zale brand, and this year is the first year in years where Zale's is actually going to be flat as it relates to space growth (ph). As we said, we're looking to open 30 to 35 stores and really, it's in the zone of 25 or so Zale stores and 10 or so Piercing Pagoda stores.

Michele Santana:

Yes, and then—and your other question in terms of the EBITDA margin associated with Zale for the first quarter, you're correct in terms of our adjusted EPS. That does include our expectation for the Zale operations to be accretive in Q1 by $0.17 to $0.18. But apart from that, we're not breaking down that guidance in terms of what the EBITDA margin or margin rate would be.

Simeon Siegel:

Okay, great. Thanks, guys, and best of luck for the coming year.

Mark Light:

Thank you.

Operator:

Your next question comes from the line of Oliver Chen from Cowen & Company. Your line is open.

Oliver Chen:

Thanks a lot. Congrats, guys. Congrats, Mark and Michele. Thanks for the…

Michele Santana:

Thanks, Oliver.

Oliver Chen:

Awesome details on the Signetization's going to be great, I'm certain. Regarding the statement on brand cross-selling and the three-year synergies, so Mark, what have you learned so far? I know you were in some initial studies there in terms of what makes the most sense. Also a related question, for the non-bridal and diamond performance of the portfolio, are you happy with where it's positioned now, and what's the innovation we might expect there? Then, Michele, I just wanted you to give us some general comments about how March margin may trend throughout the year by brands, and then you mentioned the ABS additional capacity; if you could help us understand how to think about that, that would be appreciated. Thank you.

Mark Light:

Thanks again, Oliver, for the kind words. As it relates to brand cross-selling, I want to remind everybody again, we were able to rush into a test—into our stores and literally rush into a test and get some Vera Wang product into our Kay stores, get some Neil Lane product into our Zale's and People's stores and it's very early. So early upfront, we feel good about some of the cross-selling, but we have got a lot more to do and we're going to extend and expand our testing through the first quarter. In--there's a June conference that we're—investor conference, and I will put a little commercial in for it for right now, you'll hear a lot more about that and how we are going to segment our brands, our store brands and how our product brands will support that segmentation and differentiation. But overall, there's good opportunities for brand cross-selling but it's still early to really understand where the full opportunity is.

As far as that—as I think you said, Oliver, the non-bridal or non-diamond categories of jewelry, how are we doing, and we're doing better. As you recall and during that holiday announcement, some of our lower price pointed product did not do as well—that well, but right now, we're seeing a reverse of that trend and we have a lot of—our merchants are working on a lot of exciting new lower price point opportunities that you'll hear more about into the fall season.

Michele Santana:

Then, Oliver, in terms of our gross margin trend, your question around that and breaking that out by brand, we're not forecasting or giving guidance for the year on our gross margin and we wouldn't break it down by brand; but just to try and give you maybe directionally some color around that, going back to our synergies which we've talked about, a component of our synergies does incorporate gross margin improvement, so—and we talked about 20% of our synergies being achieved in fiscal 2016. So that in and of itself would lend to an improved gross margin. Again, if gold kind of behaves where it's been, you would anticipate that we can continue to see some benefits on the

commodity cost side, but gold can be erratic and you never know quite what to predict where it's going to be or land.

Your other comment in terms of how to think through the ABS additional capacity, so a few things there. We talked about our capital allocation strategy and where we—and our leverage ratio at the end of fiscal 2015, and again, I would just remind you that that includes only a partial year from Zale. We don't see the immediate capacity in fiscal 2016 to utilize additional ABS, or asset-backed securitization, but as we move through FY '16, incorporating a full year of the Zale operation, as well as just the natural growth in our business, we'll be well positioned when we end that year and moving into fiscal '17 to revisit our asset-backed securitization and take advantage of capacity. I just remind you, our current ABS facility, we have an advanced rate of 65% under that. We currently are at about a 60% threshold, so we have an opportunity of, one, not only to increase our level of capacity under that, but also to even revisit and potentially increase that 65 to a higher number, so I just provide that color to your question.

Oliver Chen:

Okay, that's perfect. Just a final follow-up. You did mention briefly some ideas or potential opportunities around M&A. Could you just give us color in terms of what strategic or financial filters you would use in evaluating the marketplace?

Mark Light:

Well, I think what Michele was saying is that we want to make sure we have flexibility for an opportunistic M&A that we would look at it. Right now, we are focused on integrating Zale and continue to operate our business over the next 12 to 18 months, but we just want to continue to maintain that flexibility.

Michele Santana:

But with that said, I would just add, Oliver, any strategic initiative or acquisition that we would consider, first and foremost, it has to fit with our vision 2020 and our strategic plans.

Oliver Chen:

Okay, great. Thank you. Best regards.

Michele Santana:

Thanks, Oliver.

Mark Light:

Thank you.

Operator:

Your next question comes from the line of Janet Kloppenburg from JJK Research. Your line is open.

Janet Kloppenburg:

Good morning, everyone, and congratulations on a great quarter and a year.

Michele Santana:

Thank you.

Janet Kloppenburg:

Hi. I was just wondering if you could talk a little bit about when you look back on Q4, the weight of promotional activity year-over-year, and I think maybe through the holiday season, it was comparable. I'm wondering what happened in January, and if you were able to improve the promotional stance year-over-year there? Also, Mark, I wondered if you could talk about the Valentine's Day performance? I don't know if you'll give us any color on that, but I thought the stores looked great, and I thought your marketing was very strong, particularly at Zale. Just lastly, on the associate training and upgrades at Zale, how far along are you on that process and what should we be looking for in this year? Thank you.

Mark Light:

Okay, thank you, Janet, very much. First of all, as far as the fourth quarter weighting of promotion activity, as we said in January, we did not increase the amount of promoting that we did. It's comparable. What we did is we tried to target some of our promotions and make sure we had them targeted towards the right customers and make sure they were targeted towards the right events and the right timing, so—but we did not increase our promotional activity per se.

Valentine's Day, we're not going to talk about the performance other than saying that, as you saw in our guidance, was we're looking at 3 to 4% comp (ph) increases, and I think that just kind of reinforces what we think about our Valentine's Day performance. We were able to—as you saw, we did have some new (inaudible) creative for certain in all of our divisions. We did have some improved weights in (inaudible) in some of our

divisions, and we had some better targeted media placement in all of our divisions. So as a whole, thank you for your kind words about our store, we are very thrilled with what our stores accomplished at all of our divisions and some of the new, exciting new opportunities they offer to our customers.

As regards to (ph) associate training in the Zale division, we started last year—and there's a lot of talented, talented team members in the Zale division and they really are embracing our training philosophy. Last year, we started really on talking about features and the benefits, specifically in the bridal category and Vera Wang, and that type of training is a journey. You can't train 10,000 people overnight. So we continue to focus on training of diamonds, training of features and benefits and focusing on the bridal sales, and that will continue, Janet. Every year, we'll—as we said before, our Zale division and our UK division and our Sterling division are all—have different maturity (inaudible) as it relates to business, and the Zale division will continue to have enhanced training year in and year out, and sales training is a journey and it never ends. So thank you again for your kind words.

Janet Kloppenburg:

Thank you so much.

Operator:

Your next question comes from the line of Joan Payson from Barclays. Your line is open.

Bridgette Taylor:

Hi, good morning. This is Bridgette Taylor on for Joan Payson. Thanks for taking my question. Congrats on the great quarter. Just a question on Zale synergies. I think you said you're not going to break out specific line items, but could you offer any color on how we should think about the quarterly cadence of synergies this year and which initiatives more generally are driving synergy benefits in the near term and even in the first quarter? Then a quick follow-up. Within your comp guide for the first quarter, how should we think about trends for the Zale business as these stores begin to see more rapid productivity gains, and then, do you expect to see any changes in momentum of the Sterling business compared to 2014? Thanks.

Michele Santana:

Yes, so let me start with your synergy question, and Mark had talked in his prepared remarks in terms of the cadence, so that 20% in fiscal '16 and then 40%, 17 and 18%. We do believe that that 20% achievement is more back weighted to fiscal 2016, so at

this point, we believe that the impact to Q1 from net synergies is really not going to be a material number. In terms of the cadence of how the synergies and what are we going to be able to achieve quicker than others, I would say some of the SG&A initiatives are probably more at the forefront of what we'll be able to realize sooner than some of the other initiatives when you get into some of the gross margin, or when we talk about the repair. Some of those could be further down the road just given that there is an underpinning of systems require to it (ph). Then, Mark, do you want to talk about—you had some questions on the…

Mark Light:

She was talking about, I believe the, what we should expect for comp growth for Zale versus Sterling division, and we're really not giving that kind of guidance per division, but we feel very good about our guidance in the first quarter that we've given to you all.

Bridgette Taylor:

That's great. Thank you so much and congrats again.

Mark Light:

Thank you.

Operator:

Your next question comes from the line of Jeff Stein from Northcoast research. Your line is open.

Jeff Stein:

Good morning, guys, and congrats. Just a couple of questions here. First of all, wondering if you could tell us what the private label and exclusive penetration was, both at the Zale division and at the Sterling division at fiscal year end? Also, can you tell us what credit penetration was at Zale and what you might expect to see as the length data contract begins to kick in? I guess that'll be towards the end of the year. Thank you.

Michele Santana:

Hi, good morning, Jeff. Sure, so let me give you our branded penetration rate, and we'll be filing the 10-K later on this morning and those rates will be within the information included in the 10-K. So in Sterling, our proprietary and differentiated branded rate was 32.3%, and that's s up 120 basis points from the prior year. At Zale – and I'll give you a metric but bear in mind that this is just for the stub period – it's at 30.5%, so again, it's

not quite as high as our Sterling so that would suggest some opportunity and room for growth on that front.

Your other question related to Zale and their—our outsourced credit function. I'll give you the metrics in terms of what our penetration on our private credit label was. Sorry, sorry, I was just—we are at about 31% all in, and that's going to be inclusive of our US and Canada stores on the Zale's front. You're correct in that ADS, that contract will become effective October of 2015 for us and we're really excited about this. Again, we believe what ADS will bring to the forefront is the CRM and more of that marketing effort, and our anticipation is that our credit penetration for our Zale stores will be able to increase over a period of time but I don't think we're going to immediately see an increase or a substantial change in that credit penetration rate in fiscal 2016. I think it's more beyond.

Jeff Stein:

Michele, you indicated the Zale private label and exclusive penetration was about 30.5% for the stub period. On an annualized basis for the prior year, I think it was more like 11 or 12%. Was it skewed higher because of the stub period, or have you made such dramatic changes in the assortment that you were able to sharply improve the penetration this past year?

Michele Santana:

Really, Jeff, it's a combination of both. There were some branded products that previously had been excluded from, I think, how Zale had calculated their 11% number and we have aligned the category reporting to be consistent with that of Sterling, so that is a component of it. Another component is that when we pulled out, part of we talked about the non-productive inventory poll that we did on Zale and that we've replenished, and that was primarily focused in branded products, the Vera Wang, your Unstoppable Love. So those initiatives have also helped to increase what we saw in the branded penetration rate for the stub period.

Jeff Stein:

Got it. One more question real quickly. In the UK, you had begun a program to shift the real estate from high street to mall locations, and I'm wondering, has that process been complete, and if not, how far into it are you?

Mark Light:

Well, we are in the process, Jeff, of, in the UK, of making sure we can get the best real estate as a whole, and so when there's—we are in the process and we've opened

several stores in the malls, but we still have very productive stores and the better—the more and more the UK business continues to enhance our business, you're slowly seeing stores that used to be on high streets that were unprofitable becoming profitable. So we're looking at our real estate portfolio in the UK very closely every month and every year, and we see opportunities of keeping some stores in the high streets open and we still see opportunities of opening stores and outlet centers we mentioned, along with any new mall opportunity there is.

I wanted to (inaudible) one thing to Michele's point, Jeff, just so it is—the combination of the Zale penetration, as she said, was—of what she said is the calculation of how it was done, but we have done very well, as we stated, the Vera Wang Love collection, with Celebration Diamond collection, with Arts of Brilliance (ph) in Canada and with Unstoppable Love, we're seeing tremendous increases on that just with—we're working with the Zale team and trying to put some of our best practices in place.

Michele Santana:

Yes, and Jeff, I just want to throw out—help you think through that credit penetration rate that we talked about on the Zale. I'm going to split it up for US and Canada. So our US sales, about 40% of that were financed through the private label customer and then about 21% in Canada. That might be helpful just to have the metrics split between US and Canada.

Jeff Stein:

Thank you very much.

Michele Santana:

You're welcome.

Operator:

Your next question comes from the line of Rick Patel from Stephens Incorporated. Your line is open.

Rick Patel:

Hi, my congrats on a strong finish to the year.

Mark Light:

Thank you.

Rick Patel:

Can you update us on your Jared Vault stores and some of the new concepts you're testing in the mall, how they performed during the holiday and Valentine's Day periods and any updated thoughts on trying to scale those? Then secondly, Mark, can you just clarify the point that you made on lower price point items doing better right now? Are you speaking specifically to the bead (ph) part of the business, or does Jane Seymour fall into that camp as well?

Mark Light:

Okay, thank you. I had a feeling, Rick, that I wasn't clear on that, so I'll start with the last question. Our lower price pointed categories which did not perform that well as we hoped for in November and December, that the run rate has improved since then and (inaudible), and that's inclusive of all of our lower price point categories, whether it be our bead business or it be our Open Hearts by Jane Seymour business or our silver business. All of them have (inaudible) and the run rate is going into a better direction now, and compounding that, our merchandising teams in all of our divisions are always focused on lower price point. Units are very—units and foot traffic at our stores is very important and we have a lot of exciting new programs that we're working on that will be announced later this year.

As far as our new store concept that we have been testing, our Jared Vault stores, which I believe we have about 30 of them right now, have been very successful and we continue to see opportunity to open additional Jared Vaults in the United States. We had two other tests that have—we have one test that has been out in the marketplace for going on about a year or so, which is what we're calling the Jared Jewelry Boutique. We opened two stores last year, and I think we open another six stores, five or six stores this year and it's really too soon to tell. The early size, it looks like it could be an opportunity but it's way too soon to tell and we will be opening up more Jared Jewelry Boutiques so we could have more critical mass so we can really do a thorough analysis to understand the productivity of this opportunity. You will see at the June investor conference that we are also testing a new store concept coming this year, which is going to be called Le Vian by Jared, and will be opening our first store in Roosevelt Field later this year, but we're also very excited about that opportunity.

Rick Patel:

Thank you for that. Can you also comment on market prices for diamonds right now? Are they up or down versus last year? Maybe some thoughts on pricing for this year; have you made any changes year to date or does that remain option on the table?

Mark Light:

Yes, the diamond pricing is forecast to have—to be up small, not—in single digits this year. The small increases are expected this year. As far as pricing, we have the ability in our industry to do price increases, and we've been able to pass on certain targeted price increases on to our customer as well, and for the first quarter of this year, we were able to make some targeted laser-like price changes in some of our product and it's been going well so far.

Rick Patel:

Thank you very much.

Mark Light:

Thank you.

Operator:

Your next question comes from the line of Lorraine Hutchinson from Bank of America. Your line is open.

Lorraine Hutchinson:

Thank you, good morning. Now that you've been running the Zale business through a holiday season, have you found any reason why the sales per store at Zale couldn't meet or exceed the Kay Jewelers levels?

Mark Light:

We believe that the Zale brand is a wonderful brand with high recognitions just like the Kay brand, and that we also are learning – and again, we'll share at the June conference – that the Zale brand actually, within the midmarket, does have some different customer segmentation than that of the Kay business, and we don't see any reason why the Zale brand shouldn't be—have as high of an average store as the Kay brands.

Lorraine Hutchinson:

Thank you. Then just touching on Piercing Pagoda for a minute, what's your strategy going forward there? Is that considered a core part of the business? Will there be

specific merchandising initiatives around there, and what should we expect from real estate?

Mark Light:

Sure. The Piercing Pagoda division is a nice business for us. It is a new business for us, and for the first part of last year when we took over Zale's, we focused on the Zale's and People's business. That being said, we think there's a very nice opportunity for Piercing Pagoda. We have a strong team running that business, and they have been enhancing some of the merchandising programs. They've been putting in more 14 karat gold jewelry, they have been testing some other brands that could engage customers, and we are going to have some new design stores that we're testing this year also. So we're right now in the early stages of understanding the Piercing Pagoda business. We like their margins. They have very strong gross margins and we think there's opportunity—if we can get that revenue line moving at a faster pace, we think there's some great tremendous growth opportunities with Piercing Pagodas and we need a year to really get a better understanding of the business.

Lorraine Hutchinson:

Thank you.

Mark Light:

Thank you.

Operator:

Your next question comes from the line Bill Armstrong from CL King Associates. Your line is open.

Bill Armstrong:

Good morning, Mark and Michele. Nice quarter. In terms of the leverage ratio getting down to that 3.5 times, will you get there simply through growth in EBITDAR, or will this also require some pay down or reduction of debt levels?

Michele Santana:

Yes, hi, Bill, good morning. Thank you. We will just have a natural progression to get down to our leverage ratio based on the incorporation of a full year at Zale and our business growth in our EBITDA, so we will get there by the end of fiscal 2016 just based on that progression.

Bill Armstrong:

Got it, okay. Then cap ex, 275 to 325 million versus 220 million last year, is this simply more maintenance cap ex because you've got a larger store base, or are there some other projects or other things that you will be working on in terms of cap ex?

Michele Santana:

So keep in mind part of the reason why that number has increased over last year is related to Zale and a full year effect at Zale. If you look in the release, we did call out that the Zale division, we estimate that's going to be approximately 80 million to 90 million in terms of cap ex. This past year, we had guided—I want to say it was about 40 million or so of cap ex related to Zale. So that is a big chunk of the increase that you see. Other increase in cap ex goes back to IT investment, as well as there is new store growth in there and then some remodeling. But I would say for your primary factor, it is the full year of Zale.

Bill Armstrong:

Zale, okay. Okay, thank you very much.

Michele Santana:

You're welcome, Bill.

Mark Light:

Thank you.

Operator:

Your last question comes from the line of Ike Boruchow from Sterne Agee. Your line is open.

Tom Nikic:

Hi. It's actually Tom Nikic on for Ike. Thanks for taking the call and congratulations on a great Q4. I just wanted to follow up quickly on the capital allocation strategy. It kind of seems to me like the way it's progressing is that by the end of this year, you should be pretty close to your target, and then in fiscal '17, calendar '16 as the business continues to grow and you really start to see a bunch of synergies flow in, you should

really have a lot of firepower as far as dipping in to the ABS facility. Am I thinking about that correctly? You know, it kind of…

Michele Santana:

Tom, you said it and you've said it perfectly.

Tom Nikic:

Okay, and can you remind us what the interest rate is on the ABS, and is there any reason why it would change between now and then?

Michele Santana:

I believe all that information will be in the 10-K for you, and I don't have the exact number off the top of my head. It is a variable rate associated with our ABS, and overall what I'd tell you is our interest cost on our total debt portfolio is, like, about 2.5% so it is incredibly ridiculously low. Actually it's just—on the ABS, it's a weighted average interest rate of 1.5% at the end of fiscal 2015, so pretty low.

Tom Nikic:

Okay, great, thanks. Just a quick clarification about the Q1 guide?

Michele Santana:

Yes.

Tom Nikic:

You said $0.17 to $0.18 from Zale's, but that's not inclusive of financing stuff, right? It's basically just…

Michele Santana:

That would be correct and it—mm-hmm, you're absolutely right, Tom. That's just taking a pure view of the Zale operation.

Tom Nikic:

Okay, great. Thank you very much.

Michele Santana:

You're welcome.

Mark Light:

Thank you.

Tom Nikic:

Take care.

Operator:

We have no further questions at this time. I would now like to turn the call back to Mr. Light.

Mark Light:

Thank you, and thank you all for taking part in this call. Our next scheduled call is on May 28th, when we will review our first quarter results. Then on June 24th, we will be hosting a conference in New York for the investment community. We will have several insight presentations that include content on our customer segmentation efforts and how we plan to differentiate our store brands even more to maximize our share of the midmarket of the jewelry industry. Thank you all again and good-bye.

Operator:

Thank you. Ladies and gentlemen, that concludes today's call. You may disconnect.