

Signet Jewelers Limited

Fiscal 2016 Third Quarter Financial Results Call and Webcast

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CORPORATE PARTICIPANTS

James Grant, *Vice President, Investor Relations*

Mark Light, *Chief Executive Officer*

Michele Santana, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Stephen Albert, *Bank of America Merrill Lynch*

Oliver Chen, *Cowen & Company*

Anne Samuel, *JP Morgan*

Simeon Siegel, *Nomura Securities*

Scott Krasik, *Buckingham Research Group*

Brian Tunick, *Royal Bank of Canada*

Lindsay Drucker Mann, *Goldman Sachs*

Jennifer, *Citigroup*

Bill Armstrong, *C.L. King & Associates*

PRESENTATION

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the Signet Jewelers Fiscal 2016 Third Quarter Financial Results 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 the star, followed by zero. Please note that this call is being recorded today, November 24, 2015 at 8:30 AM Eastern Time.

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

James Grant:

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Good morning and welcome to our Third Quarter Fiscal 2016 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 was filed on March 26 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.

I will now turn the call over to Mark.

Mark Light:

Thanks, James. Good morning everyone. In the third quarter Signet comps and total sales both increased by 3.3%. Adjusted EPS was at $0.33 a share, a 57.1% increase over the prior year's adjusted EPS. There are four key messages that I want you to take away from our results and our guidance. First, in what has been a choppy retail environment for most, we were able to deliver same store sales growth in inline with our guidance. Our total sales increase, which came from all selling channels, were driven primarily by branded Bridal sales across all of our store banners as well as strong growth overall from Kay Jewelers, Ernest Jones, and Piercing Pagoda.

We also continue to outperform our industry, according to the latest US government and British Retail Consortium data. This was driven by a multitude of strengths that separate us from our competition such as advertising, driving jewelry trends, branding and much more.

Second, we made significant investments in store operations, systems and training during the third quarter in order to be in the best possible position for the fourth quarter and those investments are starting to pay off. While sales results in the aggregate were in line with our expectations, we saw some softness at Jared and Zales. This was a result of very specific systems investments, personnel changes and training that we implemented in the quarter. I will elaborate on these changes later in the call but suffice it to say that this was a lot of change to implement in a short period of time. We thought it was appropriate to push through these changes and investment in our smallest quarter in order to prepare us for our biggest quarter and into the future.

The third point I want you to take away is that these investments are paying off and we're seeing solid sales results across our banners thus far in the quarter, particularly at Jared and Zales. One specific bright spot is sales from our newest, must-have collection, Ever Us, which was launched on October 15th, and have exceeded our expectations thus far. We are confident heading into the holiday season given the strength of our business and our results to date as evidenced by our guidance for accelerating same store sales growth of 3.5 to 5% in the fourth quarter.

The fourth point is that our top line results are translating into strong earnings growth per share. I adjusted EPS grew by 57% in the third quarter. The Zales integration continues to go very well. Importantly, we are realizing net synergies from our acquisition integration activities during the third quarter which in part help driving operating margin 190 basis points higher or 90 basis points on an adjusted basis. While we delivered excellent earnings growth overall in the quarter, there was an modest margin impact due to a sales mix shift from Jared to Kay, which Michele will elaborate on later.

Now let's take a look at the sales drivers of the third quarter. Bridal, which is a strategic focus of ours, grew faster than Signet's overall rate of sales. The bridal business is a stable grower and insulates us

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from some of the volatility that traditional retailers face. Bridal brands such as Very Wang Love, Neil Lane and the Forever Diamond which is sold exclusively in our H. Samuel stores led the way.

Complementing those results has been the momentum of fashion collections such as Diamonds & Rhythm and diamond solitaire earrings led by the Radiant Reflection assortment, as well as growth in bracelets and a variety of jewelry for the wrist.

Also, marketing initiatives in the third quarter did well, most notably at Kay, we increased our TV weights and executed a successful multimedia campaign around engagement season. We also applied learnings from our customer segmentation study to our advertising creative which we believe is starting to resonate with our customers.

Speaking of Kay, the team had an excellent quarter across all of its selling channels and a wide variety of product collections including fashion jewelry and watches as well as Bridal.

Piercing Pagoda had a great third quarter which was driven by gold, piercings, diamonds and religious jewelry. Improvements in training and a newly designed kiosk helped results as well.

Ernest Jones delivered outstanding results across all its selling channels, driven principally by diamond and the watch business.

These gains, however, were partially offset by the multitude of investments that we made at Jared and Zales, so to elaborate a little, Jared managed a significant amount of change around field operations including coverage and selling process. Zales' initiatives included discount control policies, repair processes and more. These distracted our people a bit but it was the appropriate decision for our business to prepare us for the important fourth quarter.

While this was a lot of change to implement in a short period of time, it was important to get it done in our smallest quarter to prepare us for the fourth quarter when we expect to make over half of our adjusted EPS for the year.

Toward the end of the third quarter we launched Ever Us, our new must-have offering and the biggest product introduction in our company's history. We are about six weeks into it and Ever Us is off to a strong start. To review, Ever Us is Signet's effort to jump starting innovation in our industry. It was led by our New York design office who identified a need in the jewelry industry and developed to start a collection which is being consistently marketed and tagged with all of our store banners in the markets that we serve. The two-stone diamond ring, which is positioned to be one's best friend and true love, serves a variety of gift giving occasions in the lives of couples. Ever Us sales are greater than our expectations at this point and what's most exciting is the longer term, strategic potential of a program like this. For now, Ever Us comes in one ring style and five different carat weights, but we anticipate extending the benefit tail driven by product line extensions into maybe different ring designs, earrings and pendants and omnichannel opportunities. As a matter of fact, Ever Us has already established a strong online presence.

Part of the power of Ever Us is that it's being purchased for a wide variety of occasions. We are hearing stories from our store teams that customers are purchasing Ever Us for anniversaries, for birthdays, special mother and daughter events, and even for self-purchase. Needless to say, we are very excited to see how Ever Us is received by our customers in the fourth quarter.

Now that we are done with the third quarter in which we made significant progress around implementing initial phases of select systems, testing products and refining selling techniques, we are locked and loaded for the fourth quarter. So let's take a closer look at some of the initiatives going on.

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In merchandising, as I mentioned, we are very optimistic about Ever Us. Vera Wang Love continues to do well in all of our selling channels globally. The cross-selling effort tested so well in Jared that it's now fully rolled out to every Jared store. The Star Wars collection of beads as well as men's and women's jewelry is off to an excellent start in Kay stores. Miracle Links has expanded to all Jared stores and about 500 Kay stores, and it's the perfect gift for new moms, symbolizing the birth of a child.

In marketing, we have greater advertising weights and more impressions than last year across all of our store brands. We have applied many of our recent customer segmentation learning to our new campaigns. Our new TV ads are available to view at signetjewelers.com on our Media Center page.

Jared ran its first and very successful sales event billed Light Up the Holidays earlier this month, and Zales has one incremental preferred customer event this quarter also.

In field operations, the investment that we made in the third quarter at Zales around training, systems and processes for pure discount controls and custom jewelry are in early state deployment, and Jared has made some improvements to its selling techniques, coverage, and customer relationship management.

Our Field Operations team are highly motivated and ready to execute this holiday season. The testing of our in-house credit group offer credit sales as a third month quickly moved from a test in mid-October to full rollout here in the fourth quarter. We know that our customers heavily rely on our offline platforms to learn about jewelry compare products when they purchase online or if they purchase in-store. We are aggressively implementing changes that enhance the omnichannel experience and drive online and in-store sales. Led by our newly promoted Signet Senior Vice President Julian Shirley, mobile navigation and search has been dramatically improved. There's also greater personalization and targeted digital marketing which has elevated the efficiency and the effectiveness of our omnichannel approach to selling.

There has been more going on in this company in recent months than I can recall in my long history here at Signet. Third quarter is the time to train and plan for new initiatives and now with the fourth quarter underway and distractions to our store team members minimized, we are excited about all the new initiatives that they will deliver.

So to sum up the third quarter, Signet delivered solid sales, net synergies, operating margin expansion, significant adjusted EPS growth and completed the fourth quarter preparations effectively. We are loaded with initiatives for the fourth quarter in all the critical areas of our business, including merchandising, marketing, store operations and credit. These initiatives are already paying off as evidenced by our results to date and our expectations for accelerating same store sales of 3.5 to 5% in the fourth quarter. And we are simultaneously delivering consistent strong sales and earnings growth, achieving synergy goals, executing transformative initiatives that will facilitate long-term profitable growth and we're making the share purchases we committed to as part of our capital allocation plan. We are very confident and excited about our fourth quarter and long-term opportunities.

With that, I will turn the call over to Michele for a run-through on the financials.

Michele Santana:

Thank you, Mark. Good morning everyone. So let's begin with our third quarter sales performance. Signet's total sales and comps each increased 3.3% and on a constant exchange basis total sales increased 4.9%. Let me add some additional color on our total sales and comp performance by division.

Starting with our Sterling division, total sales increased 5.59 to $733.6 million, which included a comp increase of 3.5%. Sales increased primarily due to Branded Bridal and select diamond jewelry, most notably at Kay. This was partially offset by a comp decline at Jared. The average transaction price in

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Sterling increased by 3% and the number of transactions decreased by 0.7% due to merchandise mix shift in favor of Branded Bridal.

Our Zale division Q3 total sales were decreased by 0.5% but increased 2.4% on a constant exchange basis. Total sales were $329.9 million including a same store sales increase of 2.6%. The average transaction price and number of transactions both increased 1%. The Zale jewelry operating segment saw higher transaction growth at 2.9% and a decrease in average transaction value of 1.9% as we improved sales productivity in fashion jewelry.

Piercing Pagoda sales were driven by an 11.6% increase in average transaction value while transaction count remained flat. The higher average transaction value was primarily due to higher gold sales.

In our UK division, total sales decreased 1.1% but increased 4.9% on a constant exchange basis. Total sales were $149.4 million with a comp sales increase of 4.1% driven primarily by diamond jewelry and watches most notably at Ernest Jones. The average transaction price increased 3.4% and the number of transactions increased by 2.3%.

Moving on from sales, let's walk through Signet's consolidated Q3 performance and then we'll turn and analyze Signet's adjusted results. So on Slide 9, the table provides a reconciliation of Signet's adjusted results to consolidated to results. The difference between adjusted Signet and Signet are in the columns reflecting purchase accounting and transaction costs which includes integration-related expenses. Starting on the right side of the slide, on a GAAP basis, EPS was $0.19 per share. The next column over reflects our transaction costs which are primarily costs for consultants that are assisting us with the integration. Transactions costs were responsible for $0.11 of EPS dilution. Purchase accounting adjustments which reflects a reduction to deferred revenue and amortization of unfavorable contracts were dilutive to EPS by $0.03. And on an adjusted Signet basis, the far-most left column, EPS was $0.33.

So moving on and reviewing Signet's adjusted P&L results below the sales line, adjusted gross margin was $373.8 million or 30.6% of adjusted sales. This rate was flat to last year as the favorable impact from commodity costs and synergies was entirely offset by the impact of bad debt due to the sales mix shift from Jared to Kay. The sourcing impact at key inputs led by gold was favorable and we are starting to benefit from new initiatives principally in Zales such as discount controls, vendor terms and other growth margin enhancing programs. These factor combined improved the Zales division's gross margin rate by 120 basis points.

The Sterling division gross margin declined 90 basis points, driven primarily by the sales mix shift. This mix shift had a notable impact on gross margins given that Q3 is the smallest quarter. I'll discuss further details in a few minutes related to this.

Our UK gross margin increased 70 basis points due primarily to occupancy leverage.

Adjusted SG&A was $387.6 million or 31.7% of adjusted sales. This rate was favorable to last year by 40 basis points and was driven by store payroll leverage and partially offset by incremental investments in Zales around advertising, technology support and employee benefits.

Other operating income was $60.9 million. This increase of $7.4 million was due principally to higher interest income earned from higher outstanding receivable balances.

Adjusted operating income of $47.1 million or 3.9% of sales reflects a 31.9% increase in dollars and a rate expansion of 90 basis points. This growth was driven by the increase in sales, net synergies and SG&A leverage. The credit mix shift had a notable and partially offsetting impact on operating income

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because our operating earnings in Q3 are less than 5% of our overall annual operating earnings, so a small shift in credit has a more noticeable impact.

Adjusted EPS was $0.33 compared to $0.21 last year, an increase of 57.1% driven principally by stronger business performance. We have repurchased $30 million of Signet stock in the third quarter and $112 million year to date. This is ahead of our capital allocation plan and already within our annual buyback guidance. Nevertheless, we anticipate being in the market in our fiscal fourth quarter. We have $154 million left on our share repurchase authorization program.

So let's move on to the balance sheet and we'll begin with inventory. This is the first quarter since the Zales acquisition that we had an apples-to-apples result and our continued focus on optimization of Zales inventory is reflected within our Q3 ending inventory position. Net inventory ended the quarter at $2.7 billion, an increase of 2%. At the end of the third quarter we had 39 more stores than the previous year which is what drove the inventory growth. Now this was offset in part by outstanding inventory management across all of our Signet businesses. In our Zales division we ended narrower and deeper in our assortments which continues to be a strategic objective for us. It's important to note that our total sales increased 3.3%, which is 130 basis points faster than the growth in our total inventory. Coupled with sound inventory management across the rest of our business, this puts us in a good, clean position to assert in the fourth quarter.

So now let's move on and we'll turn our attention to our in-house credit metrics and statistics. Net accounts receivable increased to $1.5 billion compared to $1.3 billion last year, and that's up 12.3%, driven by higher sales and an increase in Sterling division credit penetration rate. Year-to-date, credit participation was 63% compared to 61.7% last year, driven by Kay. Our credit approval standards remain disciplined and unchanged. The higher participation rate was primarily driven by a greater increase of Kay customers compared to our Jared customers. The average monthly collection rate was 11.7% compared to 12.1% due to two main reasons. First, as our mix of Bridal increases due to our Best in Bridal strategy, this creates a higher average receivable. By design, the repayment rate is lower as the price point of the merchandise increases. Bridal has a higher average credit sale and therefore the repayment is longer, so this leaves a higher outstanding receivable to be collected. And second, like other consumer loans, more principal is paid off later in the life of the loan, so as our credit portfolio has grown more in the last year, proportionally more of it will be paid later.

Net bad debt expense for the quarter was $53 million compared to $41.7 million last year. The increase of $11.3 million was driven by higher receivables balances as well as the mix of customers accepting our credit, particularly by store banner. That is Jared typically has a higher tiered credit scoring customer than Kay but Kay credit sales are growing faster than Jared, resulting in a sales mix shift. Importantly, Signet has not changed its credit standards and our credit portfolio continues to perform well and profitably.

Other operating income was $6.9 million compared to $53.5 million last year. This was an increase of $7.4 million was due primarily to more interest income on the higher outstanding receivables base.

The net impact of bad debt and other operating income generated operating profit of $7.9 million compared to $11.8 million in the prior year. No changes have been made in our credit standards and the bottom line is that small changes have a more pronounced impact in the third quarter as the third quarter is our smallest quarter but our credit earnings are earned more evenly throughout the year. This modest shift in mix had a $4.5 million impact in the quarter or about $0.04 to earnings per share. We remain highly disciplined in our approval process and as a result our credit portfolio continues to be profitable and stable.

So finally, let's walk through our fourth quarter guidance. Signet's fourth quarter comparable store sales are expected to increase 3.5% to 5%, and as Mark indicated earlier, we are experiencing a strong start to the quarter across all banners based on the number of initiatives that we have put in place. Fourth

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quarter adjusted EPS is expected to be $3.40 to $3.60. Based on the investments we have made and the strong sales results we have seen to date, we are confident in this guidance.

From an effective tax rate standpoint, Signet's fiscal 2016 annual rate is anticipated to be about 28 to 29% and that's both on an adjusted and GAAP basis. Capital expenditure guidance for the full year now stands at $260 million to $280 million due primarily to timing. The reduction versus our earlier projection is attributed to a combination of store remodels, information technology and facilities that we likely won't address before the end of the fiscal year. Net selling square footage is still projected to grow approximately 2 to 3% and I would reference you to see our news release for details on how the capital is to be directed.

We remain highly confident in achieving our synergy target of $30 million to $35 million for fiscal 2016 as well as our three-year target of $150 million to $175 million.

With that, I'll turn the call back over to Mark.

Mark Light:

Thank you, Michele. So to sum up, we had a good quarter. We had our biggest product launch which is exceeding our expectations and we made some smart strategic investments and those investments are starting to pay off in time for our most important quarter.

Finally, I sincerely want to congratulate and thank all Signet team members. We believe we are very well positioned for profitable long-term growth as a direct result of the passion and dedication of the Signet team.

With that, we'll now take 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 for a brief moment while we compile the Q&A roster.

The first question is from Lorraine Hutchinson with Bank of America. Your line is open.

Stephen Albert:

Hi guys. This is Stephen Albert on for Lorraine. I guess first question would just be the increase in the bad debt expense, that's due solely to a mix shift and you're not seeing any deterioration in any of your credit metrics, correct?

Michele Santana:

That's absolutely correct, and let me just a little bit more color. Again, just to start with, every credit decision we made is done on a very thorough analysis using both predictive and statistical analysis to drive those decisions. Again, we've said this before, credit really is a competitive advantage to us that enables our sales and drives a higher customer lifetime value than a non-customer—non-credit customer. So really what we saw in Q3, and I would just draw an analogy to merchandise mix where product changes might affect rates but profit is still flowing through the bottom line. So when you think about our Q3 which is really our smallest quarter and that our credit earnings are more evenly spread throughout the year, it just has a more profound impact on our Q3. So really that increase is driven by this mix shift that we saw in Q3; we equated it to about $0.04 per share and our credit portfolio continues to operate

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profitably. It is stable and continues to perform strong and well within our expectations based on this mix shift.

Stephen Albert:

Great. Then I guess a quick follow up on the average transaction price decline at Zales. That also, you seem to indicate that was a mix shift towards fashion jewelry. You haven't made any sort of pricing investments at Zales that have driven that either, correct?

Michele Santana:

No, that's absolutely correct and that again, this is part of our strategic objectives when we looked at the Zales, Zales has always done well within the Bridal category and particularly as you moved into the holiday, the Q3 holiday season, where they haven't performed as well as in fashion jewelry, and so that's been a key area that we have looked to drive. Particularly we talked about our Unstoppable Love fashion jewelry before this Shimmering Diamond, which has been a tremendous success for us at Zales. So when you see that ATV change, it really is merchandise mix driving from that Bridal to our fashion jewelry.

Stephen Albert:

All right. Thank you guys.

Mark Light:

Thank you.

Michele Santana:

You're welcome.

Operator:

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

Oliver Chen:

Hi. Thank you. We just had a question regarding the Jared comps for sales and looking forward. Which comp lever do you think has the most opportunity? Also, Mark, can you elaborate on your earlier comments about some of the transitions regarding the training program and how that will manifest on the next? It sounds like you're in really good shape for fourth quarter. Thank you.

Mark Light:

Hi Oliver. Thank you. Yes, we do believe we're in a very good position for fourth quarter and I just want to ground everybody listening on the call that traditionally for certain in the jewelry industry we think the third quarter is an important quarter for us to train our people, prepare them for all the new initiatives and get them ready for the fourth quarter, and the third quarter is our smallest quarter. In Jared they had more going on than usual because we were focused on a lot of different areas of the business that we're trying to enhance and a lot of it came from our customer segmentation study that we did with Bain (ph) to get a better understanding of that Jared customer, that sentimentalist customer, to make sure we're interacting with them the appropriate way what they're expecting. So some of the things that we did in the third quarter, one is that we had a major leadership conference where we get all of our managers and get them trained and ready, and then our Jared team had to focus on some more specific areas of the

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business. We're changing our selling process and techniques and quite frankly, the third quarter is the time that we make sure that we have all the right team members, both from a managerial perspective and on the sales floor, that we have the right team members in place that are ready and prepared to execute our new selling techniques that correlate with our new—our Bains segmentation study. So we made some changes. We made some changes in the stores because we had some team members that weren't there and weren't ready, so we made some good personnel changes, first and foremost, then we focused on training our team members to sell differently. They actually have changed their selling techniques to get more specific with the customers and what they're looking for, as opposed to giving them a tour of our entire store whether they were looking for a tour or not. We also had some enhancements and some product launches. Vera Wang Love is rolling to all of our stores. The team members are getting to understand the Vera Wang collection better. So a lot of these changes that were made were affecting our sales because our team members were down, consciously focused on training and enhancing these processes.

Now you ask what lever will work the most, I mean there's never any magic bullet, Oliver. It's a bunch of different levers. So it starts off with the customer experience and that's a very important lever. It starts off with the advertising, the new creative of our advertising which is coming off of the segmentation. So if you're watching TV and you see our new Jared ad, it's a different creative and we're hearing wonderful feedback on the creative for our new advertising from our Jared customers through our team members, and of course having exciting new launches, whether it be Miracle Links in Jared or whether it be Vera Wang Love are all exciting for the team members.

So we think the Jared stores are just really prepared for the fourth quarter and we consciously took the third quarter to get them even more prepared.

Michele Santana:

I would just add to it, Oliver, in terms of the comp sales, again, all the initiatives that Mark has just talked to, we really believe will drive both the transaction and the ATV up from a comp sales standpoint.

Oliver Chen:

Okay. That's really, really helpful for our models. Regarding the portfolio at large, how are you feeling about the price points in terms of the balance of entry price points versus more elevated? I know it seemed like an opportunity this year versus last year. I'm just curious about that from a product and how you allocate your marketing dollars.

Mark Light:

We feel better this year than last year, Oliver. We do have a lot of new exciting initiatives at lower price points, whether it be the Star Wars beads and jewelry collection in Kay's, our Miracle Links collection in Kay's and at Jared. In the Zales division we have more Persona Beads. We actually have an exciting new launch with the Snoopy (inaudible)…

Michele Santana:

Peanuts.

Mark Light:

Peanuts, excuse me. That's just coming out now. So we have a good mix of fashion product at lower price points and we have some new announces and new initiatives at a little bit higher price points doing

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very well such as Ever Us, which is really doing well for us. So we feel a lot better about the mix of price points that we have available for our customers this year as compared to last year.

Oliver Chen:

Okay. Just our final question is in light of the tragic global events in Europe, is that a factor where your customer has an added degree of volatility, or are you different just because of your Bridal and your domestic exposure?

Mark Light:

I don't think we're different. I mean obviously with these tragic events that happen around the world has everybody concerned and we have a benefit because our product is a more preconceived purchase than that of other retail products, but we need customers being feeling secure and feeling good about their security when they go shopping. That being said, we have a lot of let's just say promotional opportunities in our tool kit and that we really have a good understanding and we've tested over the year a lot of different, elastic type of opportunities to promote if and when needed as continuously gift givings get a little more challenging. But it's important to note that we don't have the big tourism factor that other businesses have and that we see as a benefit to us.

Oliver Chen:

Thank you. Happy holidays and best regards.

Mark Light:

Thanks. Same to you, Oliver.

Michele Santana:

Thanks, Oliver.

Operator:

Your next question comes from the line of Anne Samuel with JP Morgan. Your line is open.

Anne Samuel:

Hi guys. Thanks for taking the questions. You spoke to a strong start to the quarter in November, particularly at Zales and Jared. Given Jared was a little softer this quarter, can you speak to maybe what incrementally is improved in November to date? Then also across the chain any November standouts.

Mark Light:

Sure Anne, no problem. Jared, it goes back to kind of our prepared statement. Jared has a lot going for it in that, again, we've made some changes to the team members working in the stores to making sure everybody was in unison, understood the new way of selling to our Jared clients. We have the benefit of Vera Wang Love rolling into all of our Jared stores which tested very well, so it's an incremental Bridal option for them. We have Miracle Links in those stores which is the new program for the birth of a child, which is a little lower price point which we're happy with, and also we have a great partnership with Pandora and you'll see some new Pandora ads and we are partnering with Pandora and starting to sell Pandora jewelry and pushing that opportunity even further and taking that to the next level and you'll see a TV ad this fall actually with Pandora with a beautiful Pandora ring that will be on.

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So, Jared is ready for a good fourth quarter and has a lot of incremental initiatives and product launches, and again, they have increased TV marketing spend year on year and they have new creative which we believe is getting better reaction from our customers than last year.

Anne Samuel:

Great. Thanks so much. Then you guys spoke to a choppy retail environment. Given expectations for a choppy and promotional landscape kind of across retail this holiday period, can you speak to your stance on promotions? How you plan to position yourself competitively.

Mark Light:

Yes. First of all, we start off with that we have unique exclusive brands which aren't offered by our competitors, whether it be Ever Us or it be Vera Wang Love or it be Neil Lane or it be Open Hearts by Jane Seymour and there's a lot more that we have. So just by having brands that are only available to us and that cannot be discounted by our competitors is a huge benefit to us.

That being said, as I shared with Oliver, we always have a tool kit and we're continually testing opportunities for different type of promotions and understanding the elasticity of those promotions. So we have a tool kit of promotions that we know, or at least we understand the lift that we can get from sales and incremental gross margin dollars. If the market gets a little bit more competitive will determine if and when it's appropriate to use one of those promotions that we have in our tool kit.

Anne Samuel:

Great. Thanks so much.

Mark Light:

Thank you. Have a good holiday.

Operator:

Your next question comes from the line of Simeon Siegel with Nomura Securities. Your line is open.

Simeon Siegel:

Thanks. Hey guys, good morning.

Mark Light:

Good morning, Simeon.

Michele Santana:

Good morning.

Simeon Siegel:

So I know you don't normally give it but just given the planned acceleration in guidance, can you quantify the November improvements you're seeing at Jared and Zales at all? I mean any color on the current trends by concept? Then just can you talk about the margin puts and takes at Sterling, what they look

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like going forward a little bit? Any help, Michele, you can give on how we should think about that sales mix shift, impact on credit, commodity benefits, I guess general merch margin full price versus promotional selling, et cetera. Kind of anything along there would be helpful. Thanks.

Michele Santana:

Sure. So let me start with, Simeon, as you know we're not going to quantify our results to date other than the commentary that Mark and I have already shared that we are seeing. We're off to a strong start which is factored into our guidance, particularly at Jared and Zales. So we feel very confident and good with the accelerated guidance that we've given of 3.5 to 5% comp sales.

In terms of the margins, again, I say this every quarter; we're not going to guide on particular gross margins but try and give you some additional color to help with your model. On the Sterling side, we would expect that we'll continue to see benefit related to lower gold cost. We did see benefits in the quarter related to that and that was, as I said in the prepared remarks, entirely offset by this mix shift that we saw in Q3. So as we think about the Q4, what I would expect is still to see benefits flowing through on the gold side, on our commodity side; a little bit of headwind I would imagine coming through on this credit mix shift. It's something that we'll work through but given the size of the Q4 that will be definitely less pronounced, and so I would expect that we'll see expansion.

Simeon Siegel:

Great. Thanks. Then if I could just ask one more. So it looks like you got leverage this quarter, which I don't know if it's just a simple answer of you're lapping four quarter of Zales, but can you just talk to anything that might be going on there? Because just given all the color about the initiatives that are going on, which makes complete sense to use this Q3 for kind of the get-ready quarter, I just would have assumed that we would have had de-leverage, so is there anything going on there where you found some savings or opportunities that we should think about?

Michele Santana:

Yes. You know I think part of it really just that we kind of have fully lapped the Zales acquisition. Particularly SG&A, as we talked about, we are making significant investments on the Zales division and we know that there is a lag between when we're making those investments and when we're seeing the lift coming through on our sales and our growth margin side. So I think it was moreso due to the fact that we've lapped the quarter, plus there has been some targeted cost savings, reductions that we've been looking across the business to help from a leverage standpoint. As we mover forward, the investments will continue to be there. Again, we'll have a little bit of this lag effect when you look at your sales and gross margins and the way those are flowing through. Importantly though, what I would say and what we are really pleased when we think about the Q3 is we did realize net synergies in the third quarter and Mark and I both talked about our operating margin expansion of 90 basis points in Q3. That was in part driven by the modest net synergies that we realized during Q3 and those synergies primarily are coming from our sales and our gross margin, and again, they're partially being offset by the investments that we are making within our SG&A.

Simeon Siegel:

Perfect. Thanks a lot guys and best of luck for holiday season.

Mark Light:

Thank you.

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Michele Santana:

Thanks, Simeon.

Operator:

Your next question comes from the line of Scott Krasik with Buckingham Research. Your line is open.

Scott Krasik:

Yes, hi everyone. Thanks for taking my questions.

Michele Santana:

Sure.

Scott Krasik:

I jumped on the call a little bit late. Did you quantify what the contribution from the change in the accounting for the Extended Service Plan was to comp and EPS this quarter, and then just maybe reaffirm what you think it will be for 4Q and maybe 1Q?

Michele Santana:

Sure. So, for Q3, the change in our Extended Service Plan, again, just the operational change we had made related to that had an impact of 40 basis points on our comp sales at Signet and had a $0.03 impact to our earnings per share. As we look into Q4, previously what we said, and this continues to be the case, is that we would anticipate about a $0.07 impact on earnings per share, and then from a comp standpoint, it just factored into our comps. If you kind of go back between Q2, I believe it was a 60-basis-point impact, a 40-basis-point impact in Q3, you can kind of do the math and come out and put the estimate on the comps, and at this point we haven't quantified the impact going forward after our fourth quarter.

Scott Krasik:

Okay, no, that's fine, thank you, and then can you just remind us what percentage again of the synergies you expect to achieve in fiscal '17? I know it's early, but does it seem like you're on plan? Is there a high degree of confidence? Some people are complaining that you're not accelerating the synergies now, but we're just really hitting the first quarter, so I just want to keep people's expectations in check.

Michele Santana:

No, I appreciate that. We are extremely confident in our ability to achieve our synergies, the $150 million to $175 million by the end of FY18, as well as the original targets on how the synergies should flow, and that was again 20% this year, which equates about to about $30 million to $35 million. What we realized in Q3 was really on track with what we were expecting to see. The remainder will flow through in our Q4. When you go to FY17, it's an incremental 40%, or said differently, we should realize a total of 60% of our net synergies by the end of FY17, and, again, we remain highly confident with those targets and those goals, and everything that we're seeing to date just reinforces that level of confidence.

Scott Krasik:

That's awesome, and then just last, you were going to be a secondary lender in Zale credit file.

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Michele Santana:

Yes.

Scott Krasik:

How did that play out in 3Q?

Michele Santana:

So, in our Q3, which was primarily our test period, in October, we started testing to—or collect Zale US stores, a very successful test, so that was fully rolled out for the holiday season to all of our Zale US stores. We are seeing great results, so there'll be more to come during our fourth quarter call related to that program.

Scott Krasik:

Okay, good luck. Thanks.

Michele Santana:

Thank you. I appreciate it.

Mark Light:

Thank you.

Operator:

Your next question comes from the line of Brian Tunick with Royal Bank of Canada. Your line is open.

Brian Tunick:

Thanks. Good morning, guys. I guess a couple of questions. On the Ever Us rollout, I guess first off, can you give us some idea of what kind of contribution can one product category have for the quarter, and when do we see a bigger roll-out of SKUs or marketing spend, I'm just curious, and should we assume it's the Kay division primarily that should see that kind of benefit.

Then, a second question on the capital allocation side, I think you mentioned how much stock is left under the current program, you mentioned cap ex coming down this year, but should we expect some of that cap ex dollars got deferred into next year, and just give us a thought on the capital allocation and share buyback viewpoint, maybe, for next year? Thanks very much.

Mark Light:

Sure, Brian. I'll take the Ever Us question and Michele will take the capital allocation. As it relates to Ever Us, the contribution, we don't share that information with you or anybody outside of internal of our Company, but I will tell you that it is the—as of yet, and it's early, we have a lot of business to do yet, but as of yet we're projecting it to be the biggest roll-out we've had of any new program in the history of our Company, and I'm talking even if you pull out Zale, so it's a very, very strong rollout for us, but we do not give specific contributions to the Company. I will tell you, though, that, historically, when we have an

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exciting program like this, it really does excite the store teams and the customers, so it puts a good emphasis on the business, let's just say that.

As far as the rollout, where we're going next, is we'll start testing different items. Whether it be in the earring category or the necklace category, or different ring styles, we'll be starting testing in the first quarter and the second quarter of this year, with the hopes of finding a winner and be able to extend it out into all of our brands into the fall season of next year, a year from now, and it's not Kay division primarily, this is all of our brands. It's in Kay, it's in Zale, it's in People's in Canada, it's in Ernest Jones and H. Samuel in the United Kingdom, it is in Jared, so this is not Kay only. This a brand and offering that crosses over all of our customer segments and it's working well in all of our brands in all of the countries of which we operate.

Michele Santana:

Yes, in terms of—I'll pick up on the capital allocation side. As you heard in the prepared remarks, we've repurchased 112 million of our shares to date. The guidance we had provided was 100 million to 150 million of a share buyback as it relates to FY16, and that was really on the heels of our capital allocation policy that we had unveiled last March, with one of those kind of being that we would return 70% to 80% of our free cash flow to Shareholders, either in the form of dividends and/or share repurchases; again, always subject to any strategic initiative that would come along. So, we really have met that guidance. We anticipate in the fourth quarter that we'll continue to purchase our shares. We have currently 154 million that remain under that authorized program. So, I think you need to stay tuned and you'll be hearing more on our fourth quarter call as it relates to our capital allocation plans moving into FY17 and what that means.

From a cap ex standpoint, you're right, a number of these—we reduced that guidance from what we originally had. We were at $275 million to $325 million previously and that is now $260 million to $280 million, primarily driven by timing. So, we would expect a number of these projects, particularly as it relates to IT, will be moved over to FY17, and we would expect to see elevated levels of capital expenditure for FY17 given the amount of initiatives we have in place, particularly as it relates to IT, and so we'll give you an updated capital expenditure guidance when we close out the year and our fourth quarter.

Brian Tunick:

If I could just throw in one last one. So, the Zale comp looked a little light for the third quarter. Was it a lot of what you said around Jared and the training? I mean, you're calling it out that it's strong here in the fourth quarter. Can you maybe just talk about what learnings you had in the third quarter on the Zale business and how it came in versus your expectations?

Mark Light:

Yes, Brian. As you stated, Zales run rate was a little lower than it was in the first and second quarter. Of course, we weren't satisfied with that, but we understood why, and some of the reasons why, and it's even more emphasized in Zale than it was in Jared, and in our main baseline of stores. There's a lot going on in Zale. We have a lot of training going on. We have some training, whether it be on our new discount controls. We have a new repair information system that we started to train our people on. We have a new customs system we're training our people on. We have labor scheduling, that's new for Zale. We have compensation changes that we've made with Zale. We actually even have different price tagging, we have a new task management system in place, and compounded on all of that, we also have new products that we're launching. So, Zales, it's a lot for those stores to take on, but because we had to have the experience of a lot of these systems and trainings that we've done in our US Signet business from the past, we knew we could make it happen, but it was a lot to take on.

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So, that being said, it was consciously done in the third quarter and we feel very good about the position of Zales in the fourth quarter, and as we stated, they're starting off just very well so far, very good so far going into the fourth. So, we believe we made the right decision on getting our people trained up in the smallest quarter of the year, to get the Zales team members ready for the fourth quarter, and so far so good.

Brian Tunick:

Super, that's very helpful. Thanks so much. Good luck for the holiday, guys.

Mark Light:

Thank you, Brian.

Michele Santana:

Thank you.

Operator:

Your next question comes from the line of Lindsay Drucker Mann with Goldman Sachs. Your line is open.

Lindsay Drucker Mann:

Thanks. Good morning everyone.

Mark Light:

Good morning.

Michele Santana:

Good morning.

Lindsay Drucker Mann:

I wanted to ask about traffic. Could you give us any insight into what your portfolio of stores are seeing as far as traffic goes, maybe on versus off-mall, or across the different brands?

Mark Light:

We really don't share that kind of information, Lindsay. I will tell you that, obviously, we experienced—the experience of traffic dropping in the malls and in retail affects us, but we believe it doesn't affect us as much as our other retail competitive set, because, again, we have a product that people are thinking about before they come into the stores and doing a lot of shopping online. So, the traffic does affect us, but we believe we're a little insulated as it relates to other parts of the retail world. But again, we feel very good about the amount of advertising we've got this year, our new creative that we have this year, our new initiatives as it relates to selling, and our new product launches that should hopefully increase the traffic into our stores for the fourth quarter.

Lindsay Drucker Mann:

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Maybe asked a different way, to the degree that Jared and Zales slowed some versus expectations just sequentially, was that a traffic or conversion issue?

Mark Light:

We believe it was a conversion issue more so than traffic. Obviously, it's a combination of both, but we believe, because of all the training and all the tactics we were working with with our team members in Zales and Jared, there was more a conversion issue than it was a traffic issue.

Lindsay Drucker Mann:

Okay, thanks. Then, secondly, can you talk a little bit about your outlook for pricing on a like-for-like basis, so excluding maybe mixing up the higher price products, how you're thinking about that in the fourth quarter? I know you've talked about Jared's first ever sale event, Zales having one more preferred customer event that may be offset by more promotional discounts, and an industry that's getting—seems to be getting a lot more promotional in jewelry into the fourth quarter, how you're thinking about that.

Mark Light:

Yes, Lindsay, it's a good question. First of all, I keep going back to one of the things that we have that kind of insulates us from promotion is our brands, and that our brands are not offered at our competitive set, and think programs like Ever Us and Vera Wang Love and Neil Lane, that if customers are excited about those brands they're not going get anywhere else, and so they're not going to get a discount, so it insulates us.

That being said, you're right, we have increased the amount of promoting, specifically, in Jared, because we've learned more about the Jared customer through our segmentation studies. They're a sentimentalist customer, they care about the product, they care about being engaged as it relates to when they're purchasing the product, but they still want to make sure that they're getting value and they still want to make sure they have an opportunity for that value. So, having a sale every once and while in Jared, like some other typical non-jewelry competitor of Jared, is very normal for them, and we think we're actually out of synch by not having those sales for our sentimentalist customers. So, you will see a little bit more promotions at Jared.

As far as Zales goes and the rest of our brands, we're just targeting our promotions better. We have a promotional kind of treasure chest of what we have for dollars there, and what we're doing better with Zales is we believe we're targeting those promotions better and that we're using those promotional dollars more succinctly and more effectively.

So, as far as the fourth quarter, are we promoting more as a whole? I'd say no, but in the Jared business, we are being a little bit more thoughtful due to the segmentation and understanding that customer is looking for some event sometimes.

Lindsay Drucker Mann:

Great, and then just a last question. Can you give us an update on what you're seeing in the diamond supply chain, whether it's pricing of rough and polished stones, and then also just generally what you're seeing from liquidation of some of the middlemen that compete in the diamond supply chain and how that industry is transitioning? Thanks.

Mark Light:

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Yes, it's a good question, Lindsay. There's some dynamic shifts happening in the diamond supply chain right now. Specifically, as most of you have read, De Beers had a very—not a good second quarter. There has just been some writings in our industry about the last site, meaning the last production or sale of goods coming out of their mines was substantially below the previous years, and it's primarily coming from the lack of demand from the Far East and from the Middle Eastern part of the countries, who have a demand for—primarily user demand of higher quality goods than we're using. So, right now, there are opportunities to make buys in the rough market and potentially the polished market on the higher quality of diamonds, called the VS type of goods by GIA terminology, and that's just not the goods that we use here at Signet. We're a house that uses I1s, heavy I1s, and some SI2s. So, the opportunities that are coming from the market right now are more in the higher quality because of the lack of demand from the Far East. It's not something we're seeing now. Will there be opportunities in the future? Can there be opportunities and supply chain opportunities for our Company, who's got a consistency of how we order our products? We'll see, and we'll be investigating those opportunities, but as of right now, those opportunities for better buys are really in the higher quality rough and polished diamonds that we don't use at this point.

Lindsay Drucker Mann:

Great. Thanks so much.

Mark Light:

Thank you.

Michele Santana:

Thank you.

Operator:

Your next question comes from the line of Paul Lejuez with Citigroup. Your line is open.

Michele Santana:

Good morning.

Mark Light:

Good morning.

Operator:

Paul Lejuez, your line is open.

Mark Light:

Okay, I think we'll take the next one, please, Operator.

Operator:

Your next question comes from the line of Bill Armstrong from CL King & Associates.

Jennifer:

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Can you guys hear me?

Operator:

Paul Lejuez?

Jennifer:

Yes, it's actually Jennifer for Paul. Sorry about that. I'm having some headset difficulties. First, Michele, I was wondering if you could talk a little bit about kind of the third quarter EPS miss relative to guidance. Is that due primarily to the investments at Zales and Jared, or the increase in bad debt expense, or both; and then any commentary on the semi-annual Zales at Jared?

Michele Santana:

Yes, hi, Jennifer. So, let me start with your first question in terms of the guidance. The $0.33 was impacted and quantified in terms of the prepared remarks about the mix shift related to credit that we saw from Jared over decay. That equated to about $0.04 per share. So, if you take your $0.33 and you add the $0.04, that give you a sense of where we would have been, and then, as Mark had talked about, just on some of the softness that we saw on Zale and Jared, driven by the intentional investments and our objective to use Q3 to really get prepared for the fourth quarter, also had somewhat of an impact, but it was primarily we saw from this mix shift on the credit side of $0.04.

Jennifer:

Okay, great. Then, any commentary on the semi-annual sale at Jared; and then kind of maybe a longer term picture, what are you seeing in terms of cannibalization, now that you've had Zale for a year, any new learnings there? Thanks.

Mark Light:

Yes, as far as the Light Up the Holiday event at Jared, it did well, well enough where we're telling you that we believe we're doing better in the fourth quarter, so it did well for us. We're happy with the results of the first event. As far as the cannibalization effect, it's minimal. We've studied this over and over again, and just a little bit of data for you all, from our research, 65% or more customers that shop at Kay or shop at Zales have never stepped into a Kay or Zale store, and we also track this weekly. We look at stores that have Kay and Zales in mall versus stores that only have a Kay or a Zales in the mall, and we're seeing minimal cannibalization, and we believe the more we get involved in our segmented differences from Kay and Zales and Jared, the better it's going to get, but we're seeing minimal cannibalization at this point.

Jennifer:

All right, great. Thanks and best of luck.

Mark Light:

Thank you.

Michele Santana:

Thank you.

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Operator:

Our last question comes from the line of Bill Armstrong of CL King & Associates. Your line is open.

Bill Armstrong:

Good morning, Mark and Michele. So, just a couple quick points of clarification. You discussed the impact from the shift to Kay from Jared on bad debt expense. To what extent, if any, was there an impact on merchandise margins from that mix shift?

Michele Santana:

In terms of merchandise mix, I would say there was probably a lesser impact. As it relates to that sales shift from Jared over to Kay, it was just more pronounced from the credit shift moving over to the Kay customers.

Bill Armstrong:

Got it, and then on your ring sizing Extended Service Plan change, just to clarify that was a favorable $0.03 impact for the quarter, correct?

Michele Santana:

That's absolutely correct, Bill.

Bill Armstrong:

Okay, and we'll see a favorable impact in Q4, as well?

Michele Santana:

That's correct, a favorable impact.

Bill Armstrong:

Got it. Thank you.

Michele Santana:

You're welcome.

Mark Light:

Thank you.

Operator:

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

Mark Light:

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Thank you, and thank you all for taking part in this call. Our next scheduled call is on January 7, when we will be reviewing our holiday sales results. From all of us at Signet to all of you, have a very happy and healthy holiday season, and thanks again and good-bye.

Operator:

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

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