

Signet Jewelers Limited

Fiscal 2016 Second Quarter Financial Results Call and Webcast

August 27, 2015

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PRESENTATION

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the Signet Jewelers Fiscal 2016 Second 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, August 27, 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, VP of Investor Relations. Please go ahead, James.

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James Grant:

Good morning and welcome to our Second 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 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.

Now, I'll turn the call over to Mark.

Mark Light:

Thank you, James, and good morning everyone. In the second quarter we delivered strong top line and solid bottom line results which exceeded guidance. Signet comps increased by 4.2% and adjusted EPS was at $1.28, which was a 19.6% increase over the prior year adjusted EPS.

Our success in the second quarter of fiscal 2016 was broad-based with sales and profit growth coming from virtually all of our store concepts across various geographies with contributions across our selling channels and from several functional areas. We continue to outperform our industry driven by our competitive strengths, and importantly, we're increasingly confident about our integration synergies. In addition, we are making excellent progress against each of our Vision 2020 strategic pillars.

Before I get to the second quarter and what's to come for the back half of the year, I wanted to make a few comments about our space in the jewelry industry. We have a five-year compounded annual growth rate of 12% in total sales. Signet has been gaining and continues to gain market share profitably. We consistently outperform the jewelry market and the total retail market, and based on results to date, we appear poised to deliver another year of industry outperformance.

Given the fragmented jewelry industry, we believe we have many years of profitable market share gains ahead of us. Our brands, our scale and our people give us a sustained competitive advantage. Our leading position in the jewelry marketplace has been driven by progress against each of our strategic pillars, specifically in Best in Bridal, which leads me to review our second quarter sales drivers.

From a merchandise perspective, diamond jewelry was strong. Bridal, a strategic focus of ours, grew faster than Signet's overall rate of growth and therefore gained relative share. Bridal brands such as Neil Lane, Vera Wang Love and Tolkowsky were stand outs, as well as our non-branded Bridal portfolio. Complementing those results has been the continued momentum of Diamonds & Rhythm, Unstoppable Love and our solitaire diamond earrings programs. The great work of Signet's collective teams around discount controls, commodity pricing and product design over the past year is now manifesting itself in our financial results, helping to drive not only higher sales and great value but also higher profitability and synergies.

We're also pleased to report that our marketing test initiatives are doing well and results are encouraging. What we are learning is that our radio and print spend work well outside the times when we're on television. This strengthens the continuity of our brands in the minds of our customers. We will continue to closely monitor our marketing spend as we move into the fourth quarter.

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Our key store operation performance indicator improved in the second quarter also. Our store teams are benefiting from longer, more focused district manager store visits.

So in summary, we are executing throughout the organization and it all shows in our financial results. Not only do we have good momentum coming out of a very productive second quarter, but we also have a variety of new catalysts to drive our business into the second half of the year. Among our merchandise initiatives that we are excited about are Miracle Links, which is a perfect pendant for new moms, symbolizing the birth of a new child. We're also proud to announce a new partnership with ALEX AND ANI which we'll test in 108 Jared stores beginning in mid September. ALEX AND ANI is a leading edge, trend-right fashion collection that is very popular with the millennials and a natural traffic driver. We also have the Chosen Diamond which is a program that we'll test in 60 Jared stores this fall and is expected to resonate with the sentimentalist customer that Jared attracts. It provides documentation from rough to finished polished diamond so customers know the steps of their own diamond's journey.

Vera Wang Love continues to do very well in our Zale stores. The cross-selling effort tested so well in Jared that Vera Wang Love will now roll out to all Jared stores this fall.

We also will be one of select jewelers who will sell Star Wars fine jewelry and beads this holiday season which will be sold in our Kay stores, and in late October we intend to launch a new must-have jewelry product that we first referenced at our Investor conference in June. This collection, which will be in all of our national store banners in the United States, the United Kingdom and in Canada, will be supported with one of our most comprehensive marketing programs in the history of our company.

Speaking of marketing, we will apply many of our recent customer segmentation learnings. For instance, Zale will have a new TV creative campaign with higher media weights called Diamond Kind of Love, which has tested very, very well. Kay marketing will be focused in classic to resonate with the gifter customer profile. And Jared will begin running semi-annual special events to launch new products in order to stay relevant with select customers who seek value opportunities.

We'll also test a new store design for Zale and for Piercing Pagoda, and we'll continue growing the latest concepts in store design for Kay. Again, all of these designs are lined with our segmentation learnings.

We'll continue to drive custom jewelry with the new jewelry technology for custom in Zale stores.

These are just some of the many catalysts that we are investing in throughout Signet and we are just getting started; there are many, many more to come.

So on my final slide I want to take a minute to reiterate a few important points about our favorable position in the jewelry space. Our people are getting ready for the busy fourth quarter selling season. We have just completed successful district manager meetings in preparation for our managers' leadership conferences. Our conference preparations are nearly complete and there's great excitement around this year's agendas and this year's exciting new initiatives that we'll be driving home for our field operations organization. Our pipeline of merchandise is tested and full. We have a variety of line extensions and new programs designed to be fresh, exciting, consistent with our strategy and relevant with our core customers at each of their shopping locations. The merchandise this fall will be supported with new marketing creative that has been placed extremely thoughtfully to maximize its impact, and all of this is culminated to generate momentum behind our business as our same store sales have improved throughout the quarter.

In closing, our business is strong and this was also recognized by Standard & Poor's as Signet was added to the S&P 500 during the second quarter, which is a great honor to us to be added to this iconic index.

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I am extremely confident in Signet's prospects for the near term, the medium term and the long term. With that, I will turn the call over to Michele for a run-through on our financials.

Michele Santana:

Thank you, Mark. Good morning everyone. So let's start with our second quarter sales performance. Signet's total sales increased 15.1% and comps increased 4.2% above our guided comp range of 2% to 3%, so let me share with you some additional color on our sales and comp performance by division.

In our Sterling division, total sales increased 5.9% to $858.5 million, which included a same store sales increase of 3.3%. Sales increases were broad-based across store banners, products brands and non-brands as well as omnichannel. Bridal and diamond jewelry also were particularly strong. The average transaction price in Sterling increased by 4.2% and the number of transactions decreased by 2.5% due to merchandise mix.

Our Zale division total sales were $389.3 million for the quarter which included a same store sales increase of 5.8%. We saw particular strength in branded Bridal and branded diamond fashion. Sales increases were also favorably impacted by our continued integration initiatives around sales associate training, targeted promotional events and new marketing creative. Also, keep in mind that the prior year quarter had 26 fewer days due to the acquisition occurring on May 29, 2014.

In our UK division, total sales decreased 2.3% but increased 6.4% on a constant exchange basis. Sales were $159.1 million with a comp sales increase of 5.1% and that was driven primarily by Ernest Jones. Both UK store concepts reflected strong results in Bridal and watches. The average transaction price increased 4.3% and the number of transactions also increased by 1.8%, driven by merchandise mix.

As mentioned in our earnings release this morning, the second quarter comp sales were favorably impacted by 60 basis points associated with an operational change that we made to align Sterling's extended service plans, or ESPs, with Zale and in which we viewed Zale as having a best practice related to the extended service plans. This operational change that related to ring sizing triggered a change in the revenue and expense recognition rates associated with our ESPs. So previously, in the Sterling division, the cost of ring sizing for customers who had purchased an ESP were not included as part of the extended service plan claims. So now since this alignment, the cost for ring sizing for customers who purchased an ESP are included in claims costs. For those customers who elect not to purchase an ESP and need ring sizing, a nominal fee is charged for this service. So the net impact is that more sales and profit are now recognized earlier within the Sterling division ESP sale and this change is entirely non-cash. So again, this operational change is just another example of Signet sharing best practices across the organization.

Excluding the impact of this ESP change, Signet's comp sales would have been 3.6%, 60 basis points above the high end of our guidance.

Moving on from sales, let me walk you through Signet's consolidated Q2 performance before we turn and analyze Signet's adjusted results.

The table you see on Slide 9 provides a reconciliation of Signet's adjusted results to consolidated results. Now the difference between adjusted Signet and Signet are the columns reflecting purchasing accounting and transaction costs which include our integration-related expenses. So starting on the right side of the slide, on a GAAP basis, EPS was $0.78 per share and that was lower than our guidance due to the legal settlement of $34.2 million related to the Zale acquisition appraisal rights matter. This settlement is recorded within transaction costs as SG&A and the settlement finalizes the appraisal litigation and no further costs associated with this litigation are expected to be incurred.

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The next column over reflects our transaction costs. Transaction costs were responsible for $0.46 of EPS dilution and that's inclusive of the $0.39 from the appraisal settlement we just spoke of.

Purchase accounting adjustments, which reflect a reduction to deferred revenue, amortization related the inventory fair value step-up, and amortization of unfavorable contracts were dilutive to EPS by $0.04.

On an adjusted Signet basis, the far-most left column on the slide, EPS was $1.28, higher than our guidance of $1.11 to $1.16. Now we'll discuss our adjusted results in more detail momentarily, but first let's turn and look at our operating income by division.

Our second quarter fiscal 2016 operating income was $100.8 million or 7.2% of sales, reflecting a 20.7% increase over prior year, and that also reflects a 40 basis point increase in operating margin rate. Components of operating income consisted of the following: Sterling Jewelers was $157.8 million or 18.4% of divisional sales, reflecting a 21.5% increase over prior year and that was up 240 basis points in rate from last year.

Zale operating loss was $2.1 million or 0.5% of division sales and that's inclusive of purchase accounting adjustments. Zale's performance consisted of a $2 million loss from the Zale's jewelry operating segment and a $0.1 million loss for the Piercing Pagoda operating segment. Now excluding these adjustments—and you'll see this in a moment on Slide 11—the Zale division operating profit was $3 million or 0.7% of adjusted division sales.

Our UK operating profit was $3.2 million or 2% of division sales and that's up 130 basis points from last year.

Other, which primarily consists of our corporate and administrative expenses and Signet's diamond sourcing subsidiaries, includes $43.6 million of transaction costs which also includes the $34.2 million related to the appraisal settlement.

So now this is the last quarter that we will show the detail of the Zale operations. Next quarter, we will provide Zale details that are consistent with our divisional disclosures as we will have fully comped the acquisition.

So the presentation on Slide 11 takes adjusted Signet, which is shown on the far right, and then breaks it into two parts. One part is Zale operations, which is shown 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 and inclusive of finance interest and taxes. So from sales to operating income, this gives you comparability to prior year results. In addition, the information is provided to give you visibility as to how the Zale operations performed in the second quarter, and again, I would just remind you that the prior year Q2 had 26 fewer days as the acquisition occurred on May 29 of 2014.

So continuing on, let's look at Signet's adjusted P&L results below the sales line. Adjusted gross margin was $500.1 million or 35.3% of adjusted sales, and that was up 100 basis points driven principally by higher sales, favorable commodity costs and merchandise synergy initiatives in the Zale division. Excluding the Zale division, the adjusted Signet gross margin rate would have been 35.7% and that's up 90 basis points, principally driven by favorable commodity costs and partially offset by net bad debt due to higher credit sales in the Sterling division.

Adjusted SG&A was $413.4 million or 29.2% of adjusted sales, up 80 basis points due to the incremental investment in Zale, principally surrounding advertising, information technology support and employee benefits. So excluding Zale, the adjusted SG&A rate was 27.5%, favorable by 10 basis points over last year. This was driven by store payroll leverage and nearly offset by higher central costs primarily related

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to legal fees associated with the appraisal settlement. These legal fees associated with the appraisal litigation will no longer be incurred on a going-forward basis.

Other operating income was $62.8 million. This increase of $9.1 million was due principally to higher interest income earned from higher outstanding receivable balances. Adjusted operating income of $149.5 million or 10.5% of sales reflects an 18.8% increase and up 30 basis points in rate. This growth was driven primarily by the increase in sales and gross margin. Importantly, excluding the Zale division, the adjusted Signet operating margin rate would have been 14.4% leveraging up 170 basis points. This result shows the operating leverage inherent in our business model.

Adjusted EPS was $1.28 compared to $1.07 last year, an increase of 19.6% driven by stronger-than-expected business performance, a lower tax rate and operational change associated with the extended service plans that I discussed earlier. The impact from the extended service plans change was $0.05 on adjusted EPS in the quarter.

We repurchased $60 million of Signet stock in the second quarter and that's in line with our capital allocation plan. At the end of the second quarter, there was $183.7 million remaining under Signet's 2013 share repurchase authorization program.

So now let's move on to the balance sheet and we're going to first start with inventory. Net inventory ended the year at $2.4 billion, an increase of $68.9 million. This 2.9% increase over last year was driven primarily by, first, new store growth; secondly, our diamond sourcing initiative. We continue to become more vertically integrated by procuring more rough diamonds to meet the needs of all of our divisions and to support our strategic initiative to be Best in Bridal.

Finally, those factors were offset in part by strategic initiatives to increase Zale inventory turns. Through focus on eliminating slower-turning SKUs and increasing merchandise that's more relevant to Zale's influenced customers, we are making significant strides in streamlining the division's inventory. Signet ended the quarter well positioned in inventory as we move into the third quarter, ahead of the holiday selling season.

So now 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 13.5%, driven by higher sales and an increase in Sterling's division credit penetration rate. Year-to-date, credit participation was 61.6% compared to 60% last year. The increase in credit participation was attributed primarily to credit decision engine improvements and strong customer acceptance of our credit offerings. The average monthly collection rate was 12% compared to 12.4%, due primarily to three reasons. First, our customers continue to opt more for our regular credit terms which do require lower monthly payments compared to the 12-month interest-free program. Second, as our (inaudible) Bridal increases due to our Best in Bridal strategy, this creates a higher average receivable. Our required schedule payments do not increase proportionally with the higher merchandise mix shift. Third, just like other consumer loans, more principal is paid off later, so as our portfolio has grown more in the last year, proportionally more of it will be paid later.

Net bad debt expense for the quarter was $49.5 million and that compares to $41.8 million last year, an increase of $7.7 million and that's driven primarily by the growth in receivables balances from the increased credit penetration and the change in the credit program mix.

Other operating income was $62.8 million compared to $53.7 million last year. This was an increase of $9.1 million and is due primarily to more interest income on the higher outstanding receivables as well as the shift away from interest-free programs.

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So the net impact of these two items was income of $13.3 million compared to $11.9 million in the prior year, or an increase of $1.4 million. The portfolio continues to perform strongly as evidenced by the net impact of our bad debt and other operating income. The allowance as a percentage of A/R of 7.3% increased over last year due to timing. That is, in Q2 last year, accounts receivable grew due to the credit decision engine introduction but the bad debt that would come with any A/R growth lagged, so this created an unusually low percentage last year which we are now lapping.

So sticking with the subject of credit, just a few comments regarding the third-party credit in our Zale stores. We are really looking forward to transitioning to our new partner Alliance Data Systems. This transition is expected to occur around fiscal year end which is a change from our original projection of October. All the financial and operational virtues of having ADS as our partner remain in place but will be deferred just a few months due to some administrative issues. We're very pleased that Signet's in-house credit team will be testing a second look credit in late October for our Zale stores. Following a successful test, we expect the in-house credit team will fully support all Zale US stores for the holiday selling season.

So let's move on to the financial guidance for the third quarter. Signet's third quarter comparable store sales are expected to increase 3% to 4%. Third quarter adjusted EPS is expected to be $0.36 to $0.40, which does include a modest favorable impact of $0.03 from the extended service plan revenue recognition change. From an effective tax rate standpoint, Signet's fiscal 2016 annual rate is anticipated to be 28% to 29%. Our capital expenditure guidance for the full year remains at $275 million to $325 million and our net selling square footage is projected to grow approximately 2% to 3%. I would also reference you to our news release for further details on how the capital is to be directed.

We remain increasingly confident in achieving our synergy targets for FY16 as well as our three-year period. As we noted at our Investor Day, we see the long-term potential for Sterling operating margins to reach 19%, Zale to reach 15% and the UK 10%. This represents a substantial margin opportunity in our business.

We are very pleased with our financial performance in the second quarter, and with that, I'd like to turn the call back over to Mark.

Mark Light:

Thank you, Michele. In conclusion, we're seeing terrific collaboration throughout all of Signet. Our business continues to gain momentum, current trends are strong and we are increasingly confident in our ability to achieve our synergy targets. In fact, we are already starting to see the benefits of synergies impact our operating results.

I want to congratulate and thank all of the Signet team members for a great second quarter. We are well positioned for the second half of the year and for profitable long-term growth as a direct result of the passion and the dedication of our 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 Oliver Chen with Cowen & Company. Your line is open.

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Oliver Chen:

Hi. Congratulations on a really spectacular momentum and all the efforts ahead. Mark, on the product side, you had a lot of great announcements with ALEX AND ANI and Star Wars and the must-have jewelry item. How do we prioritize which ones will be the biggest drivers for the newness on holiday on a year-over-year basis? Do you guys expect a similar kind of composition and comp between the mix impact and number of transactions as we look forward to holiday?

Mark Light:

First of all, thank you, Oliver, for the kind words. As far as prioritizing the newness, they all are just part of what's going to get us to have a wonderful fourth quarter. We're obviously very excited about partnering with ALEX AND ANI to test, but our new must-have program is something that is a first for us and we think this will really move the dial also and is something that is going to cross all of our national brands, so we're very excited about that. As I mentioned in my prepared comments, this is the most we've invested into one launch in the history of our company from a marketing perspective, so the new, exciting must-have program is definitely something that we're all excited about. We're excited about all of our new—some programs can increase traffic and some can just increase average sale; we're just excited about all of them.

As far as the…

Michele Santana:

In terms of the comp mix between your average transaction, price and transaction, our goal and our view of the pipeline of product innovation that Mark talked to is that it's going to drive both of those.

Oliver Chen:

Okay. The favorable commodity costs side, I know in the past you can use that strategically to also reinvest in the business or engineer product differently, but we're seeing continued good trends there. What should we model going forward for how that may impact your gross margin?

Michele Santana:

Sure, Oliver. So again—and I'll just start with it and I feel like a broken record because I think I say this every quarter on the call—we don't give guidance in terms of our gross margin or breakdown that gross margin in terms of what the expectations are from lower commodity costs, but what I would tell you is that we expect that we'll continue to see a benefit from the lower commodity prices rolling into our gross margin rate. The other thing I would just add to that is remember that we are on an average costs method so benefits don't always immediately drop to the P&L, but what we're seeing with this longer sustained—particularly as it relates to the gold commodity cost, we continue to expect to see benefits coming in from commodity pricing.

The other thing I would just add real quick on that, Oliver, is when you look at—and this was really exciting for us—when you look at our gross margin, particularly on the Zale side, we're also being impacted by all the great synergy initiatives that we and the teams have been working so hard on. So we're really seeing that take root in terms of gross margin. I know Mark and I previously talked about discount controls. We have that up and running, so besides the commodity pricing which will definitely take the benefit of that, we're really reaping the reward from our synergy initiatives.

Oliver Chen:

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Okay, and just finally on that topic, what would you say has made you increasingly confident in the synergies, just it feels like a more optimistic tone, and I guess it's because you've been experiencing more about what's possible? I just wanted to get context for the upticked optimism in the synergies.

Mark Light:

Sure, Oliver. I mean, if you think about it, as we've stated, Zale's has just now comped one year, and so the more and more we get to (a) know the Zale business, and (b) our Team—we have a team that we call the Transformation Leadership Team—is getting their arms around all the opportunities, and our Teams across our organization, is just getting more and more confident and seeing more and more opportunities, and the more we get our systems to enable us, it just gives us that more confidence. So, yes, we feel more confident about hitting our synergy goals for a lot of the above reasons, our Team members, the benefits of technology, and us just understanding the business that much better every month.

Michele Santana:

Yes, and I would just add to that really quick, Oliver, that the other thing that's also increasing that confidence, and albeit it was still relatively immaterial for the quarter, but we are starting to see those synergies flow a little bit faster into our financial results than we originally expected. So, everything that Mark said, combined with that, is really giving us this increasingly confident view.

Oliver Chen:

Thanks. Thanks, Michele. Thanks, Mark. Congratulations and best regards.

Michele Santana:

Thank you.

Mark Light:

Thank you, Oliver.

Operator:

The next question is from Lindsay Drucker Mann with Goldman Sachs. Your line is open.

Lindsay Drucker Mann:

Thanks. Good morning, everyone.

Mark Light:

Good morning, Lindsay.

Lindsay Drucker Mann:

I wanted to ask about the improvement in comp momentum in Sterling, specifically in Jared, if you could just maybe give a little bit more detail on what drove some of the sequential acceleration. I know that, you know, particularly against the industry backdrop, it seems like it's struggling a little bit more, and maybe some detail on how the cadence of comp was across the quarter. Thanks.

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Mark Light:

Thank you, Lindsay. First of all, we're very happy with the momentum of our Jared business. As good retail merchants do, we investigated everything that was going on in our Jared business, as we do with all of our business, and we're able to test certain different programs. As we stated in the last call, we tested a new radio marketing vehicle, it seems to be doing well, as I mentioned in my prepared comments. We have new products that we've been testing, whether it be the Vera Wang LOVE that we shared with you, or the Miracle Links that I shared with you; and in our business it's always about the people, and our Operational Team came up with a focused, targeted effort as it relates to in-store customer experience and they were spending more time in the stores; and, lastly, we have tested some targeted promotions that were more targeted to dealing with the customers in Jared. So, a combination of all the above is why we believe that Signet's Jared division is continuing to do well, and we feel pretty good about the Jared business going into the fourth quarter, also.

Lindsay Drucker Mann:

Would you be able to provide any detail on the cadence of comp across the quarter, and then just a follow-up question I have is—it's exciting to hear about the ALEX AND ANI testing—can you help put into context—you said 108 Jared stores—maybe how, when you've tested prior initiatives, whether it's Vera Wang LOVE, or even when you started with Pandora, how that testing looked in comparison, and how, as you ultimately went to full roll-out, what we should sort of think of in terms of timing of getting those in stores and incrementality of comp? Thanks.

Mark Light:

Sure. First of all, Lindsay, we don't comment on the cadence of our comp increase, so I can't talk to you about that. As far as the ALEX AND ANI test, first of all, the test begins in our Jared stores, 108 of our Jared stores in September, so we have no data as of yet, but I will tell you that 108 stores out of our Jared portfolio of roughly 250 stores is a pretty healthy test for us, and we feel pretty good about ALEX AND ANI, but, again, it's a little bit less than half of the portfolio of Jared, but we feel good about it, we're excited about the opportunities of our Team members to work with ALEX AND ANI, and we're looking forward to seeing some new millennial customers walking in our door looking for this fashionable product. It's something we haven't really offered in the past. So, we're very excited about the test and we'll update the market on this more when we get to the season.

Lindsay Drucker Mann:

Great, thanks so much.

Mark Light:

Thank you.

Operator:

The next question is from Lorraine Hutchinson with Bank of America Merrill Lynch. Your line is open.

Stephen Oliver:

Hi, this is Stephen Oliver on for Lorraine. I just wanted to get a little bit more—on the fashion-wide launch, the channel-wide fashion launch that you're planning for for holiday, how have the initial tests been going for that?

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Then, also, a second question on the synergies. You mentioned you're seeing them rolling in faster, how much did you recognize of the 20% this year in the quarter; and then how about a breakdown across gross margin and SG&A?

Mark Light:

Okay, I'll take the question about the fashion launch and Michele will talk to the synergies and the gross margin.

As far as the fashion launch, you need to understand that we've done a lot of research, and so we had—first, started with customer research as it related to the product and the concept behind the product, and our research was phenomenal, as well as any research that we saw, and that we have seen in the past. Then, we put certain items in the stores, did a good tests in all of stores, which tested very well. So, from our perspective, both from the research perspective and from the in-store test perspective, we think we've got a real winner here for the fourth quarter, and as I stated earlier, it'll be announced to the public by the end of October or so.

Michele Santana:

Yes, so in terms of the synergies—and, again, you're correct, you know, what's made us much more confidence in terms of our view of our synergies is we are starting to see those benefits roll in a little bit faster than we had originally anticipated. It's still, overall, I'd say relatively immaterial to the quarter as a whole, and on a net basis, the guidance we gave for fiscal year 2016 was about a $30 million to $35 million range, or 20% of the 150 to 175, so that is large the comp between the Q3 and Q4 quarters, and we would anticipate that the realization of those synergies over those quarters would be somewhat proportionate to the size of those quarters.

The breakdown of what we're seeing at this point in time within the quarter has primarily been a lot of the benefits are coming in on the sales and the gross margin side, and the initiatives surrounding our training, targeted promotions, cross-selling, on the gross margin side, a lot of the work that the Teams have been doing over the merchandise assortment, the discount controls that we talked about, a lot of those are really taking root.

Now, on the SG&A side, we're not yet quite seeing those benefits there, because what we're doing is making a lot of investments back into the Zale division to kind of support the sales and gross margin initiatives. So, these investments include what I talked about on the call, the advertising, the IT support. So, right now, there's a little bit of a lag between those investments that are sitting in SG&A and when we get the leverage on the sales side coming through.

Stephen Oliver:

Thank you.

Michele Santana:

You're welcome.

Operator:

The next question is from Rick Patel with Stephens. Your line is open.

Rick Patel:

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Thank you. Good morning and congrats on the strong results in a tough environment.

Mark Light:

Thank you.

Michele Santana:

Thank you.

Rick Patel:

Lots of new products this fall. I guess, what are you going to de-emphasize in order to make room for these new initiatives? Then, can you also remind us how much of the assortment represents branded products today and how that's going to change going forward, and also the margin implications of that?

Mark Light:

Thanks, Rick. As far as what we're going to de-emphasize, I wouldn't target anything specifically. It's just a matter of what we're going to focus on and we're going to react to what the consumers react to. So, I don't want to say that we're de-emphasizing any of our product categories. It's just how we determine what goes on here and on TV and what is advertised in print. So, I don't want to say there's anything that we're de-emphasizing. I want to say there's a lot of exciting new programs that we will be emphasizing.

Michele Santana:

Yes, and in terms of the composition of our branded portfolio, it's about 32% on the Sterling side, and in Zale it's somewhat lower than that, which represents the opportunity and part of the initiatives that we've been working on over the past course of the year to increase that branded portfolio. We talked about the introduction that we made with the Unstoppable Love. So, we'd expect to see that portfolio increase on the branded side.

Rick Patel:

Then, also a question on supplementing Zale's credit program. So, based on the initial that you've done, can you put into context how many more credit transactions you might be able to capture, you know, versus what ADS is able to cover, and any color on what that opportunity would be like going forward?

Michele Santana:

Yes, this is exciting for us—and, again, I have to give kudos to our Team, because they really have done a great job in order to get everything up and running to start the test pilot that we'll be doing in October. I can't really give you context in terms of how many more credit transactions. What we do know is ADS, they're actually able to approve at yet a deeper level than our current credit provider in Zale. With our in-house Credit Team, we're able to yet approve even at a deeper level over ADS. So, there is some benefit in terms of us becoming a second-look provider to the Zale. I would leave it at that.

Rick Patel:

That's great. Thank you very much.

Michele Santana:

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Thank you.

Mark Light:

Thank you.

Operator:

Your next question is from Simeon Siegel with Nomura. Your line is open.

Simeon Siegel:

Congrats, great results.

Mark Light:

Thanks, Simeon.

Michele Santana:

Thank you.

Simeon Siegel:

So, anything you can share on the new Jared concepts and new stores. It looks like there was a nice uptick in new store productivity there, so any color on how those are doing.

Then just two quick clarifications for me. Mark, did you say that in the prepared remarks, did you say comps improved throughout the quarter? Then, Michele, I just wanted to confirm that the current third quarter guidance doesn't any ADS benefit. When did you say that should start hitting the P&L? Thanks.

Mark Light:

As far as the new Jared concepts, the Jared Vaults are doing well. It's the Jared outlet concept and we're very happy with the performance of Jared Vaults. Our Jared Jeweler Boutiques, we still have about, I think, eight of them, still too soon to tell and we're still watching the results of those. We just opened up Le Vian by Jared in Roosevelt Field up in New York, and, again, that just opened and it's too soon to tell. So, of the three Jared concepts, we're very happy with Jared Vault and we'll still watching Jared Jeweler Boutiques and Le Vian by Jared.

Michele Santana:

Simeon, just a point of clarification, because we have a lot of acronyms that are flying around, did you say ADS or the extended service plan?

Simeon Siegel:

Yes, sorry, the Alliance Data.

Michele Santana:

Okay, okay, I just wanted to make sure that I heard the question correctly.

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Mark Light:

Also, Simeon, I did not talk to increasing comps during the quarter, so I don't know where …

Michele Santana:

We just said our comps had improved throughout the quarter.

Mark Light:

Throughout the quarter. We weren't specific about the cadence.

Michele Santana:

Yes. So, what I would say is the guidance that we provided into Q3 incorporates any consideration of us doing the in-house second look program, and then, as I mentioned in my prepared remarks, the Alliance Data System, that will kick in towards the end of the year.

Simeon Siegel:

Great. Thanks a lot, guys. Best of luck for the rest of the year.

Mark Light:

Thank you.

Michele Santana:

Thanks, Simeon.

Operator:

The next question is from Joan Payson with Barclays. Your line is open.

Joan Payson:

Hi, good morning, everyone, and congratulations on the great results this quarter.

Mark Light:

Thank you, Joan.

Michele Santana:

Thank you, Joan.

Joan Payson:

I was hoping you could talk a little bit about Bridal, because it sounds like that continues to outpace the total, especially at Sterling? It's half of the business now, but how high do you think it could ultimately be in terms of mix. Also, is that Bridal growth a product of the overall market and category, or is Signet taking share at a faster rate than the overall business?

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Mark Light:

Well, thank you for recognizing our Bridal growth. We see our Bridal category growth as a journey, and it's something that we don't have a ceiling on it. We believe, and I've said this before, that in our business, it's the closest thing that we have as to a necessity, and that our Bridal business continues to grow with enhanced customer service behind the counter, understanding how to connect with the customers, as it relates to a Bridal sale, which is very unique. We continue to have new and exciting Bridal brands that continue to do well, with Vera Wang LOVE, and Neil Lane continues to do well, and Tolkowsky continues to do well, and we're always testing new Bridal assortments both in our branded and our non-branded products. We just believe that the Bridal category for us is something that is a journey and that we will not have a ceiling.

As it relates to the market, weddings have been pretty constant, not growing a lot, and what we're seeing is we believe we're gaining market share, and we believe we're gaining market share both from a unit perspective, but we're also seeing our average selling price of engagement rings going up, and only part of that is due to the consumers are getting engaged at an older age and it's benefiting us, in that we're selling a higher average bridal engagement ring, and we think that's something that will continue going into the future.

Joan Payson:

Great, and also could you talk a little bit about whether there's been any recent changes to the overall jewelry category momentum in the US, and maybe the promotional environment, as well?

Mark Light:

As far as the promotional environment, Joan, we're not seeing it getting more promotional. I know, as it relates to our business, what we're trying to do is take out promotional dollars and be more thoughtful and more targeted in how we are using those dollars, and it's working. So, as to (inaudible), we're not seeing the industry being more promotional, and at Signet, we're being more targeted with our promotions.

Joan Payson:

Great. Thank you, Mark and Michele. Have a great day.

Mark Light:

Thank you, Joan, you too.

Michele Santana:

Thank you, Joan.

Operator:

The next question is from Scott Krasik with Buckingham Research. Your line is open.

Scott Krasik:

Yes, hi, everyone, and let me add my congratulations.

Mark Light:

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Thank you.

Scott Krasik:

Just a couple questions, I guess. First, the portion of the synergies that you guys always targeted relative to sales synergies, are we seeing that now in terms of the introduction of Vera Wang jewelry at Jared, are there other major things that we're going to see in 2016, and maybe talk about how you quantify that and how you're tracking to it?

Michele Santana:

Sure. So, let me start, and then, Mark, if you have any additional comments you want to add, feel free. So, we are starting to realize, as I mentioned, the benefits. I would say right now a lot of it does relate to the cross-selling initiatives we've put in place. These synergies work both ways, right? Particularly, as we look at the Vera Wang, a lot of the initiatives we had on the Vera Wang side surrounding our marketing creative, the product assortment, we're seeing a benefit on the Zale side of that. We're also, as Mark had indicated, on the Jared side, with the cross-selling, they're rolling that out to all of our stores. So, we're definitely well on our way as it relates to the cross-selling synergy goals that we had in place. We expect that that will continue, in terms of our cross-selling initiatives, throughout the remainder of the year and going into next year.

The other big element as it relates to synergies on the sales side that we had talked about was on the repairs. So, that is one that we're still working through that initiative as it relates to our repair sales, which there isn't a lot of underlying system support that we really need to get that initiative up and running. There's been a lot of work that we've done to date on that and I think that's one that you would expect to see probably more so in FY17.

Mark Light:

Just to pile on, Scott, the selling that Michele talked to is definitely exactly appropriate. Also, as it relates to selling, the synergies, we're sharing best practices at selling behind the counter is very important. Some of our best practices as it relates to engaging with Team members, Leadership conferences, career development schools, training, those are all the type of synergies that we're sharing with the Zale's Team, and we cannot talk enough about what's going on on our gross margin line. You saw what happened in the second quarter. Our gross margins are a big part of our synergies. We've talked about discount control, we've talked about some mix factors, we've talked about commodities. So, gross margin is also a big part of our synergies going forward and starting off in the second quarter.

Michele Santa:

Yes, and one other thing I would just pile on is targeted promotions. So, this has been another great sharing best practice and collaboration among our divisions, relating to what we refer to as our preferred customer or gift service events, or sales events. So, we've had a lot of great learnings and synergy initiatives and realizing the sales synergies associated with these targeted promotional events.

Mark Light:

To pile a little more, because we are excited about this and it needs to be said, another nice thing that we're learning, speaking about promotions and other aspects of the business, is we're learning a lot from the Zale business. They've had some unique promotions that we're testing in Sterling, which is working well, as we've talked about, the ESP operational changes. So, it's going both ways, from Sterling to Zale, and we're sharing that with our UK business. So, we are excited about the opportunities in the synergy area and feel very confident about those.

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Scott Krasik:

Awesome. Then, just last, Michele, I think you were maybe trying to temper expectations in terms of the pace of improvement in the Zale's operating margins as we get into next year, but you said you're getting synergies maybe a little earlier than expected and you have this opportunity to be a second-look provider, which would contribute something for Zale. So, maybe are you a little bit more optimistic in terms of the pace of the improvement in the Zale's margins versus June?

Michele Santana:

So, what I would say, I mean, I was very optimistic in June when I talked about our medium-term and long-term operating margin opportunities associated with Zale, and that medium-term being low-teens, or call it 12%, and long-term being 15%, I was very confident then and I remain extremely confident on our ability to achieve those goals.

Scott Krasik:

Okay. All right, well, thanks and good luck.

Mark Light:

Thank you, Scott.

Michele Santana:

Thank you.

Operator:

The next question is from Janet Kloppenburg with JJK Research. Your line is open.

Janet Kloppenburg:

Good morning, everyone. Congratulations on a nice quarter. Just a couple of follow-on questions. With regards to ALEX AND ANI, I assume that's an exclusive assortment that you'll be marketing, and I'm wondering, Mark, if it is successful, which I assume it will be, will that be a brand that could be transferred across other concepts in your brand portfolio?

I also was wondering about the platform launch for October, what the ASP and margin profile of that—I believe it's a fashion jewelry launch, but I'm wondering if it would carry higher ASPs and margins that could potentially help to benefit the P&L more than we are expecting at this time?

Lastly, Michele, on the commodity pricing, we're seeing gold pricing being pretty soft on a go-forward basis, so I'm wondering if that could provide some favorable input pricing for you next year, in terms of gross margin gains? Thanks so much.

Mark Light:

Thank you, Janet. First of all, I want to make it very clear I didn't say anything about an exclusive assortment from ALEX AND ANI. What I said is we're testing ALEX AND ANI in 108 of our stores. I did not mention any type of exclusive assortment. As I've said, we're very excited about …

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Janet Kloppenburg:

No, no, Mark, I was asking whether or not they were developing a line exclusively for you, or if it was, you know, product that was currently in their line.

Mark Light:

It is product we're working with ALEX AND ANI that is in our stores, there's nothing that's exclusive as of yet, and while we're working with ALEX AND ANI we'll see how the test goes, and we're very excited about that opportunity.

Janet Kloppenburg:

Okay.

Mark Light:

As far as the must-have product that we're going to have in the fall that we're kicking off the end of October, we are very excited about it. We're not going to share price points or gross margins, because we don't do that, but obviously we see the benefits in getting incremental sales, and so we're excited about the opportunity to bring in new customers and existing customers to find a new must-have product and we'll benefit on the top line. That's what we're looking for.

Michele Santana:

Yes, and then in terms of the commodity pricing, yes, assuming that we still have a sustained softening in the gold price, we'll continue to be able to reap the benefits of a lower input or commodity cost going into the back half of this year and that would continue as we look forward into next year.

Janet Kloppenburg:

Great. Thanks so much and good luck.

Mark Light:

Thank you, Janet.

Michele Santana:

Thank you.

Operator:

The next question is from Bill Armstrong with C.L. King & Associates. Your line is open.

Bill Armstrong:

Good morning, Mark and Michele. On the commodity cost, we know diamond prices have been under pressure. In general, if diamond prices are down—you know, just pick a number, 10%—does that have a kind of umbrella effect on other precious gems, as well, rubies, emeralds, et cetera? In other words, do they tend to trend in the same direction?

Mark Light:

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Okay, let me start with the tail end of it. No, they do not. Rubies and emeralds and sapphires, and other semi-precious or precious gems, do not have any indication on diamond pricing, they're not interconnected, so let's start with that.

So, let me give you a little bit of background on what's going on in the diamond market. First of all, the diamond prices have been reduced, and what's happening in the diamond market, is primarily what's happening with the slowdown of what's going on in Asia and the Middle East, and the diamonds that are heavily sold in Asia and the Middle East are higher quality diamonds than we sell at Signet. They're VS quality, from a GIA terminology, and better, and our quality of goods is not as a whole—we sell VS goods, but as a whole we don't sell that higher tier of quality of diamonds. So, the opportunities where diamond prices are lowering is really more in the higher end rough and the higher end polished goods. It doesn't mean there may not be an opportunity for us, but for right now, what's happening in the diamond market, those lower priced opportunities are in the higher end priced or higher end quality of goods.

Now, also remember that we're on a cost averaging perspective, and I'm Michele will talk to that soon, so when and if we see opportunities to increase savings on our diamond purchasing, it takes a while to get through the system. I don't know if you want to talk to that, Michele?

Michele Santana:

Yes, I will just add when you think about our averaging cost method, we don't immediately recognize the benefits of lower commodity pricing. It also works inversely the same. If there's higher commodity prices, that doesn't immediately manifest itself in our P&L because of our average costing method. It's really when we get into the sustained lower pricing or a sustained change in pricing that we start to see it come through the P&L, which is really the case on the gold side. We've, for a good year now, have been seeing the lower gold cost and that is driving the benefits in our income statement.

Bill Armstrong:

Right, right, I understand the average costing method. So, just to be clear then, when you're talking about getting the benefits of lower commodity cost, in your case, we're really looking at gold and metals rather than stone?

Michele Santana:

Yes, yes, that's absolutely correct, Bill.

Bill Armstrong:

Okay, okay, and then just one other quick follow-up. On the ESP ring sizing adjustment, I think you said you had a $0.05 per share benefit in Q2 and we should see about $0.03 in Q3. Should we also see something like that in Q4 and Q1, and then it'll anniversary after that?

Michele Santana:

Yes. So, in terms of the impact that we talked in the prepared remarks, as you said, about the Q3 impact, the modest impact there, when you think about the Q4 impact, we would anticipate again a modest impact on our earnings per share related to the extended service plan change. What I would say is, given that Q4 is our biggest sales quarter that impact will be higher than what we guided in the Q3, but, proportionately, it will be lower to EPS at a $0.07 impact.

Bill Armstrong:

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Got it, okay, and then, again, once we get to Q2 of next year, then we're anniversaried and we're on an even footing.

Michele Santana:

Correct, that's absolutely correct, Bill.

Bill Armstrong:

Got it, okay. All right, thank you.

Michele Santana:

Thank you.

Operator:

The next question is from Jeff Stein with Northcoast Research. Your line is open.

Jeff Stein:

Congrats on the quarter and—so a couple of questions. Just to follow up on Bill's question, is the expected savings from the—or the expected benefit from the ESP change in Q4 going to be larger—likely to be larger than it was in Q2; and secondly, is the expense impact of that embedded in gross margin or SG&A?

Michele Santana:

Yes, so let me address that, Jeff. As I just mentioned with Bill, we would anticipate the impact in Q4 would be slightly larger than Q2, just given the size, the higher sales volume we have in Q4, but in proportionate to EPS would be substantially lower at $0.07 of an impact. In terms of the expense, that does sit in gross margin.

Jeff Stein:

Okay, great. The delay in the ADS contract, given the fact that you expect a $22 million benefit on an annualized basis, should we just assume that there will be a negative $5.5 million impact, roughly, in Q4? This is what we've been modeling.

Michele Santana:

Yes. So, not that we're ready to give Q4 guidance, but just to help you out on that front, Jeff, in terms of the prepared remarks, though, we had talked about is, yes, ADS will be effective in January versus what we originally anticipated in October, and the financial virtues remain the same with the $22 million annual benefit related to the lower merchant costs. What we have done, though, is with the second look credit actions that we're going to be taking in October with the plan, that that will roll out before the holiday season, that would mitigate any deferral of impact from that ADS. Does that help you?

Jeff Stein:

Yes, that does. A couple of other ones real quickly. The transaction drop at Sterling of 2.5%, you alluded to mix. Can you amplify on that little bit?

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Michele Santana:

Yes, sure, so let me—in terms of the transaction, when I referenced mix, again, what we're seeing is more transactions in terms of our Bridal and our higher selling priced items, and that, from a transaction standpoint, is somewhat offset by lower ticket transactions.

Jeff Stein:

Okay, and were your Bridal units up in the second quarter, number of units sold?

Michele Santana:

Let me just double check it and we can get back to you on that one. I want to say yes, that would be the case, but I don't have that information at my fingertips.

Jeff Stein:

Okay, and a final question on marketing. For your new fashion product, are you putting out incremental marketing dollars or is this going to take away at all from other collections that you would normally spend X millions of dollars on?

Mark Light:

Our impressions, as a whole, for all Signets in the United States will be up, and what we're doing is we're investing dollars in this new program, that this for the first time will cross over all three of our national brands. So, our impressions will be up, and when we determine what we put on TV, we'll make a very thoughtful decision as it relates to categories, and so we feel very good about our portfolio that we'll be putting on TV and advertising this year.

Jeff Stein:

Thank you.

Mark Light:

Thank you, Jeff.

Michele Santana:

Thanks, Jeff.

Operator:

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

Mark Light:

Yes, thank you, and thank you all for taking part on this call. Our next scheduled call is on November 27, when we will review our third quarter results. Thank you all again and goodbye and have a nice day.

Operator:

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Thank you. Ladies and gentlemen, this concludes today's conference call. You may now disconnect.

Operator:

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