

Signet Jewelers Limited

Fiscal 2017 Second Quarter Earnings Conference Call

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PRESENTATION

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the Signet Jewelers Limited Q2 Fiscal 2017 Results Conference Call. During the call all participants will be in a listen-only mode. After the presentation we will conduct a question and answer session. Instructions will be provided at that time. If at any time during the conference you need to reach an Operator, please press star, followed by zero. Please note that this call is being recorded today, August 25, 2016 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.

James Grant:

Good morning and welcome to our Second Quarter Fiscal 2017 Earnings Call. On our call today are Mark Light, CEO, and Michele Santana, CFO. The presentation deck we are 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

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uncertainties and actual results may differ materially. We urge you to read the Risk Factors, Cautionary Language and other disclosures in our Annual Report on Form 10-K. We also draw your attention to Slide 2 in today's presentation for additional information about forward-looking statements and non-GAAP measures.

Now, I will now turn the call over to Mark.

Mark Light:

Thanks, James. Good morning everyone. I'd like to start by discussing the key points we want you to take away from our second quarter financial results presentations. First, Signet sales and earnings were disappointing in the second quarter, giving no sign yet of a rebounding trend. This negatively impacts our annual guidance. We will elaborate on what has happened and the impact to guidance later in this presentation.

Second, our synergy work streams remain solid and their financial impact is still intact. We have a long list of synergy activities which I'll discuss in a few moments. Although some initiatives are unfavorably impacted in a lower sales environment, most are not, so we still expect to deliver on our synergies.

The third point I want you to take away is that we bought back 4% of the Company during the second quarter and several Directors and Officers made open market purchases as well. We did this in response to our valuation and to demonstrate our confidence in Signet.

Fourth, our credit strategic evaluation is moving forward. As you know, we are analyzing opportunities to create shareholder value by optimizing or monetizing our portfolio while continuing to do business with our customers. I'll have a few comments later but the bottom line is this: either way we expect shareholder value to be created.

Fifth, we are pleased to announce that Signet and Leonard Green Partners have entered into a strategic partnership and with the private equity firm will invest $625 million in Signet through a convertible preferred security. Details are described in a separate release.

Lastly and most importantly, our holiday season initiatives are numerous, well-tested and ready. So let's get into some more details.

Why the disappointing results in the second quarter? What happened? Well, it was a combination of several things, some macro and some micro.

Regarding economic factors, our stores in states and provinces closely tied to the energy industry dramatically underperformed the division averages. It didn't matter the store banner, the price point or the merchandise brand, it was an obvious across-the-board trend. Zales especially has a large presence in Texas. Signet's underperformance was clear in other places like Louisiana, Oklahoma and Alberta, Canada. Net-net, energy regions accounted for approximately half of our comp decline within North America.

The latest US government jewelry report recently revised 2015's year-end industry growth down to just up 0.2%. The BEA's latest estimate for the year, which are frequently revised, are still below historic norms. MasterCard's SpendingPulse also notes a Quarter 2 slowdown in jewelry sales. This slower industry trend and outlook is further corroborated by the Jewelry Board of Trade's recent report on independent jewelry store closures, and we have informal industry feedback.

Jared's underperformance accounted for a material part of our miss. Texas-located Jared stores account for less than 15% of the Jared store count, however these stores accounted for nearly half of Jared's

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comp decline in the second quarter. We believe Jared has a number of fundamental issues that have not been quick and easy fixes. We now better understand the unique characteristics of the Jared customer through our segmentation work and we are taking the following actions.

We are enhancing our selling capabilities to be able to better sell the entire store while minimizing or eliminating customer hand-offs. We are improving upon our marketing creative along with targeting our media buys to more effectively communicate with the segmented Jared customers. We are distinguishing merchandise assortments to be more unique to Jared, such as the Chosen Diamond and our Pandora boutiques, and we are testing a variety of pricing tactics to ensure our team members have the tools they need to compete and win.

Moving to Slide 5, I'd like to discuss some of the sales wins during the second quarter. Results were led by Ever Us, our two-stone diamond jewelry collection. Ever Us is now testing line extension in stores for the holiday season and many are already showing significant promise. Bracelets and earrings as well as necklaces with on-trend looks and innovative fastening systems were also successful in the quarter.

We released some significant improvements to our Kay and Jared online experience. The design, navigation, imagery, speed and ease of use are all significantly upgraded.

Finally, our real estate portfolio diversity served us well as our leading results came from our outlets and mall-based kiosks.

Shifting from sales initiatives to synergies, and to review a synergy as we define it, it is a net contribution to operating profit. Most of the synergies we are recognizing this year relates to gross margin enhancements and operating expense decreases as opposed to sales increases. I won't go into depth on each of the 14 examples listed on Slide 6 and the workstream detail behind each one, but as you can see we've got a tremendous amount of activity going on to fully optimize the integration.

In spite of decelerating sales, we are still confident we will hit our synergy targets because most of the synergies are not dependent upon sales. For example, in-sourcing repair. The complete overhaul of the Zale repair model saves expense on each repair. Non-merchandise sourcing: our greater scale allows us to reduce costs on products and services we buy on a per unit basis. Distributions at our operations: we are going to save on the consolidation of two distribution centers into one. Each of these and many, many other projects will make us leaner and position us even better for long-term growth.

Let's discuss the fourth quarter where we have historically made about half of our annual profits, and so our attention and focus is now intensely directed to our holiday season business drivers. I'll elaborate on some of them here.

Again, one of our biggest initiatives is Ever Us and in our experience, beacon or industry trend-driving strategies like this tend to perform even better in Year 2 versus Year 1. This year we will offer additional jewelry categories and styles, higher carat weights, more inventory, greater print, social and TV marketing of the Ever Us collection. We have continued our collaboration with Forevermark which is a diamond brand of the De Beers Group of Companies, and we are pleased that they will be supporting the Ever Us program in their stores that carry Forevermark, by the way which includes Jared, with a TV campaign of their own in the fourth quarter. This will undoubtedly further increase the reach of the campaign and consumer's desire for Ever Us nationwide.

Finally, Ever Us will have a greater merchandising and marketing presence in our stores in Canada and the UK this year.

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We are expanding the iconic Vera Wang Love Bridal Jewelry collection into fashion jewelry in nearly all of our Zales stores. The collection will include diamond jewelry as well as pearls supported with new in-store displays. Marketing will support the new merchandise collection through television and PR events.

This holiday season, all eyes are on the ear as we continue to drive trends in earrings, earring climbers, studs and hoops. We also see a lot of promise in our Radiant Reflections and Endless Brilliance collections which create bigger looks with smaller stones and innovative settings.

In our Jared stores, we are resetting our Pandora presentation with beautiful new Pandora store-in-stores or boutiques. As a part of it, we are selling a broader collection of Pandora products and fashion jewelry and will support it with new TV advertising creative. We are rolling out the Chosen Diamond program to all Jared stores which show the customer each stage of a diamond's journey from rough to finished jewelry. This is in total alignment with the Jared customer who tends to value this type of product and information moreso than our other store banners. We are also designing a brand new TV creative to support the Chosen.

In Kay and Jared, we are rolling out a new software that we call Clienteling to enable our teams to interact with customers more intelligently based on their previous purchases and special life occasions.

One of our omni-channel strategies is to strengthen personalization. In the fourth quarter, online consumers will see more personalized content based upon previous interactions of our brands. They will also benefit from more personalized store locator experience.

Lastly, in addition to new creative marketing that will support each of our initiatives I just mentioned, we have many targeted marketing plans tying into the 100th anniversary of Kay Jewelers. We have contests, promotions and awareness campaigns using all forms of media.

Moving on to the strategic review of our credit portfolio, I'll share with you a few very high level updates and comments. As I noted at the onset, we are analyzing opportunities to create shareholder value by optimizing or monetizing our credit portfolio while continuing to have the capability to do business with our customers. On the optimization front, we are examining how we can change our credit business model to maximize value and disclosure and minimize accounting complexity.

On the monetization front, we have launched a request for proposals process and thus far we are very pleased with the interest in our credit book and there are multiple interested parties that we are in discussions with.

We are motivated to move as quickly and as prudently as possible in order to remove uncertainty around this issue for all of our constituencies.

One critical point that I want to make sure you are all fully aware of and appreciate is that we expect shareholder value will be created under either scenario. If we optimize the portfolio, we'll likely increase leverage against it and use the proceeds on growth initiatives, buybacks and/or dividends. Furthermore, we will likely revamp and expand our reporting and disclosure of credit profitability, contractual aging and other metrics. If we monetize the portfolio, it means we will preserve satisfactory near-term and long-term economics for Signet and reduce risk to our balance sheet. Again, we hope to conclude this whole process as soon as possible.

We are very pleased to announce that Leonard Green Partners has agreed to invest $625 million in Signet. The transaction is a significant vote of confidence in the Signet operation model and our long-term prospects for growth. We opened our books and shared significant amounts of information as a part of this process, and with the benefit of full due diligence on the Company, Leonard Green decided to

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make a sizeable investment and we are very excited to have managing director Jonathan Sokoloff assume a seat on the Signet board.

The goal was to find a party with significant resources and broad financial and retail expertise who could become a large owner and partner with us for the long term as our business evolves. The timing in this deal is perfect in that our business is going through a transformation, including the credit portfolio review, and we look forward to having the benefit of Leonard Green's perspectives as we complete the process.

The successful investment here should also serve as a validating signal to the public markets about the long-term strength of our business model and our practices as a whole.

In return for its cash investment, Leonard Green will own convertible preferred stock in Signet. The transaction itself was designed to be financially neutral as Leonard Green's investment will be based off the market price of our shares, and we will be recycling the capital into share repurchases at similar prices, thereby making it a wash from a financial perspective. What we therefore get from the transaction is not capital but the experience, resources, financial acumen and retail expertise that Leonard Green brings to the table. Having a large owner with skin in the game and their skill set will strengthen our board and add a tremendously valuable perspective as our business model continues to evolve. The transaction is expected to close in the third quarter of this year and is subject to getting customary regulatory approvals.

We believe the long-term secular and company-specific picture looks promising. We think our competitive strength, our long-term opportunity for growth and our precedent of success make us a worthy long-term investment; certainly Leonard Green did.

Signet plays in an industry with a long history of growth and although the latest year grew minimally, we have seen this before and bounced back with higher market share. People still fall in love and adorn themselves in jewelry as they have done for literally thousands of years. Signet has some of the best-known and most trusted jewelry retail brand names in the world. Knowing that customers interact with us first online and then potentially long after the sale through our services, we are developing an omni-channel experience that will be best-in-class.

Customers can now become better educated and see a wide range of options regardless of where they engage with us and what they're engaging us for. Few in retail jewelry can match the depth and breadth of experiences that Signet offers. Given our scale and our experience, we can create and drive jewelry trends better than anyone in the industry. Innovation and the power of our brands are in their infancy stages in the jewelry industry and we are best positioned to take advantage of this.

Our numbers clearly show that a strong presence on television not only drives sales but also market share gains. Our strategy is to have a strong presence on national TV at the right times, while others who sell jewelry don't gives us a distinct competitive advantage.

We have a diverse real estate portfolio in locations that provide solid returns. We are profitable in the mall and outside of it, in high-volume properties and low-volume properties, in kiosks, in outlets and in power centers. Our diversity in terms of retail channel and retail location is serving us very well. We continue to maintain a disciplined internal rate of return requirement of 20% on new stores, and we see our best opportunities these days in Kay Jewelers stores outside the mall.

As a major industry player, scale obviously helps in the dealings throughout our supply chain but it's about much, much more than just scale. We have the experience. We have the know-how. We have the relationships and we have the processes that are difficult for others to match who do business in the diamond and jewelry industry.

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Much like other companies that sell valuable things like cars and computers, we at Signet sell products, we finance them and we insure them. It's a complete end-to-end solution that our customers embrace and makes great business sense for us.

Lastly, we have the financial wherewithal to compete and win in all types of business environments. We have weathered difficult times before, we have invested what others couldn't, we know how to strike that appropriate balance between growth and savings, and we believe we'll come through all of this stronger than ever.

That concludes my remarks and now I'll turn over to Michele.

Michele Santana:

Thank you, Mark. Good morning everyone. Let's start with our second quarter sales performance. Signet's comps decreased 2.3% against an increase of 4.2% in the prior year second quarter and that also compares to a two-year hurdle rate of 9%. As Mark indicated, of our comp sales decline, about half of the decline was driven by oil and gas reliant regions. Total sales decreased 2.6% and on a constant exchange basis, total sales decreased 1.3% for the quarter.

In looking at total sales and comp performance by operating segment, I'll share some additional color. In Sterling Jewelers total sales declined 2.2% to $839 million. Comps decreased 3.1% compared to an increase of 3.3% last year and that also compares to a two-year hurdle rate of 10%. Sales weakness was most pronounced by store banner and geography, notably Jared stores in energy dependent regional economies. These declines were partially offset by higher sales of select diamond collections as well as fashion categories.

The Zale jewelry's operating segment's total sales decreased by 1.6% to $331 million and 1% on a constant currency exchange basis. Comps were down 3% and that's against a two-year hurdle rate of 4.8%. Looking on a geography basis, our Zale US total sales were flat; comps decreased 2.2% and that's against a two-year stack rate of 4%. In Canada, total sales declined 9.5% or 5.9% on a constant currency basis. Canadian comp sales declined 6.8% and that's against a two-year hurdle rate of 8.2%. The Zale jewelry's operating segment's decline throughout North America was also driven by weakness in energy-dependent economies, and again, this was partially offset by sales of select diamond jewelry collections.

Our Piercing Pagoda total sales increased 7.8% to $57 million with comp sales of 6.4% and that is on top of 8.4% last year and a two-year rate of 5.6%. Sales increases were driven predominantly by gold chains and diamond jewelry.

Looking in the UK, our UK total sales decreased 8.7% to $145 million but increased 2% at constant currency rates. Comps grew 0.8% and on top of a 5.1% in prior year and compared to a two-year rate of 9.5%. Diamond jewelry and prestige watches were the primary drivers of the sales increases that we saw in the UK.

Moving on from sales, we'll look at Signet's consolidated and adjusted results. Again, we're continuing to present the reconciliation that you see on Slide 12 to reflect the impact of purchase accounting as well as severance and IT implementation expense associated with global systems that will drive future synergies. The difference between Signet and adjusted Signet are in the columns reflecting purchase accounting and integration cost.

If we start in the lower left portion of the slide, on a GAAP basis EPS was $1.06 per share. Moving to the next column over, purchase accounting adjustments were worth $0.04 of EPS dilution and this was driven primarily by deferred revenue adjustments related to acquisition accounting.

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Moving over, the next column reflects our integration costs which relate to consulting cost related to IT implementation as well as severance. Integration and severance costs were also responsible for $0.04 of EPS dilution.

On an adjusted Signet basis in the far right column, by adding back the $0.08 worth of adjustments, adjusted EPS was $1.14 per share.

We're going to look below the sales line at Signet's adjusted P&L results. Our adjusted gross margin was $468 million or 34% of adjusted sales, and that's down 130 basis points due primarily to lower sales that resulted in deleverage on fixed costs such as store occupancy, as well as higher bad debt expense primarily due to higher receivables. This was partially offset by the realization of synergies.

Adjusted SG&A was $409.1 million or 29.7% of adjusted sales compared to $413.4 million or 29.2% of adjusted sales in the prior year. The 50 basis points of deleverage in rates was also due principally to lower sales. I'll go into more detail on SG&A in the following slide.

Continuing down, Other operating income was $70.7 million or 5.1% of sales. This increase of $7.9 million was due principally to higher interest income earned from higher outstanding receivable balances.

Adjusted operating income was $129.6 million and that decreased 13.3% over prior-year second quarter. Our adjusted operating margin rate was 9.4% of sales with the decline in rate due to the lower top line. Adjusted EPS was $1.14 per share compared to $1.28 last year, a decrease of $0.14 or 10.9%.

Let's take a closer look at our SG&A. Our teams really did a great job on focusing on cost controls and savings. Our SG&A expense in dollars, as you see, declined by $4 million or 1% year-over-year despite unplanned expenses that we experienced in our quarter. Although the dollar reduction in SG&A wasn't enough to leverage our SG&A rate on lower sales volume, it does reflect solid management of expenses nonetheless. Within SG&A, the biggest expense component is payroll and that is both at the store and the corporate level. As shown on the slide, stores and corporate payroll declined and that's driven by a combination of less variable compensation that flexes with sales, including corporate incentive compensation; synergies associated with both store and corporate payroll, and lower expenses due to favorable exchange, foreign exchange.

Advertising was prudently managed to just a $1 million increase.

We also incurred unplanned costs of $5 million on consulting and related expenses due to the unsubstantiated claims against Signet's business integrity.

Other expenses increased driven predominantly by our IT roadmap including higher depreciation and amortization.

All of that led to a small decrease in our SG&A expense.

Moving off the P&L I want to hit a few balance sheet highlights and we'll start with inventory. Our strong second quarter and inventory position reflects the success of our continued focus on inventory optimization. Net inventory ended the period virtually flat at $2.4 billion. Our teams again did a great job at managing in a slow environment while at the same time not starving the business of growth opportunities. The impact from more stores was virtually offset by the impact of sound merchandise management and foreign exchange on inventory procured in currencies other than the strong US dollar.

We'll move on and we're going to focus on our in-house credit metrics and statistics.

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Our second quarter in-house credit sales in the Sterling division were $529 million, that's down 1.7%, and although lower, the in-house credit sales were slightly more favorable than the division's total sales decline and therefore gained relative share in the mix of tender. In-house credit participation was 63.1% and that is up 50 basis points due to more effective credit marketing and greater receptivity among our highest quality cohorts. As a result, we continue to see growth in credit sales mix within our best credit tiers.

The average monthly payment collection rate for the second quarter of Fiscal 2017 was 10.8% compared to 11.3% last year. Our monthly collection rate is calculated as cash payment received divided by beginning accounts receivable. The decline in the collection rate is due principally to credit plan mix. We're now operating a 36-month plan for select eligible borrowers in our mall stores. So as participation in this plan grows, the monthly payment collection rate will slightly decline. Importantly, the 36-month plan enhances the quality of our receivable portfolio. This has been tested for three years and fully rolled out this year. The plan requires a $3000 minimum purchase on bridal jewelry. That means it is only open to borrowers who qualify for a $3000 line or more, our lower risk customers, and because it is available for bridal jewelry, there's a stronger emotional connection and implicit commitment to repay.

The combination of collection rate decline and growth in credit participation led to an increase in our net accounts receivable of $146 million or 9.1% to $1.75 billion.

Interest income from finance charges, which makes up virtually all of the Other operating income line on our P&L was $70.1 million compared to $62.9 million last year. The increase of $7.2 million was due primarily to more interest income on the higher outstanding receivable base.

Our net bad debt expense was $55.3 million and that compares to $49.4 million last year. The increase of $5.9 million in expense was driven primarily by our higher receivable balances and a slight impact from an increase in non-performing loans which I'll address momentarily. The net impact of bad debt and finance charge income generated operating profit of $14.8 million and that is up $1.3 million from last year.

Now, let me take you through some of the key Sterling division allowance for doubtful account metrics. Our total valuation allowance as a percent of gross receivables was 7.4% in the second quarter. This slight increase of 10 basis points from prior year was driven by an IT glitch relating to customer reminders during the second quarter which resulted in slightly higher roll rates in the over 90-day aging category combined with overall receivable gross. On a sequential basis, the ratio was up 80 basis points, the same as prior year, reflecting our seasonality changes.

That same trend was true for the non-performing portion of our receivables as a percent of gross receivables. At 4.4%, this was also up 10 basis points from prior year and up 80 basis quarter-over-quarter for the same reasons that I just discussed. Again, the sequential trend of non-performing loans was the same versus the prior-year period.

In summary, we remain absolutely confident in our ongoing credit portfolio performance based on the visibility that we have into our daily collections, our weekly roll rates and other key performing metrics. Our portfolio continues to enable responsible and profitable growth of our merchandise sales and earnings.

I'd like to move now and just spend a few minutes relating to our capital allocation. As mentioned in the release and earlier in this presentation, we made a concerted move to repurchase an unprecedented amount of stock in a single quarter. We bought back 4% of shares in Q2. Now, I want to limit my remarks on stock valuation, recognizing that this is quite frankly more of your job than mine, but when a market leader in a growing industry with a solid balance sheet reports record Q1 earnings in May and

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then goes on to get rewarded with the lowest valuation on the S&P 500 Specialty Retail Index, well, then it's time for unprecedented buybacks.

Our lenders recently gave us a vote of confidence by agreeing to an amendment and extension of our revolving credit facility. Signet had a $400 million line for many years, but with the acquisition of Zale we are now a much bigger company with more seasonal needs and generally more going on. This new $700 million line is now commensurate with the size and the activity of our company, so approximately $200 million of that revolver was tapped in Q2 to help finance the share repurchase. With that, we're going to turn to financial guidance.

Signet's third quarter comparable stores sales are expected to decreased between 3% and 5%. We have seen challenging trends in the summer and with no seasonal catalysts we are not expecting a change in these trends for most of fall. Third quarter adjusted EPS is expected to be $0.17 to $0.25. By the way, that guidance includes an expected one-time $0.07 benefit from the effects of harmonizing Signet's compensated asset policies. Not until the holiday season kicks in do we expect to see a trend inflection point for all the reasons that Mark had just previously stated. That's why for Fiscal 2017 we anticipate comps to decline a more modest 1% to 2.5% and adjusted EPS of $7.25 to $7.55. This annual adjusted EPS guidance does suggest a growth rate of about 8% and that is driven primarily by synergies, cost controls, higher finance charge income as well as a lower effective tax rate and accretion for share repurchases. Our annual effective tax rate is anticipated to be 27% to 28%.

Our capital expenditure guidance for the full year has been reduced to $280 million to $320 million. As you may have noticed in our earnings release put out this morning, we did not change our projected store count ranges, so the reduction in capex moves us closer to the lower end of the ranges, and the reduction primarily relates to deferral of select IT projects.

Projected net selling square footage also remain constant as we continue to expect growth of 3% to 3.5%. Most of Signet's new square footage growth is slated for real estate venues other than enclosed malls and focused on the Kay off-mall banner.

Again, we are reaffirming the multi-year synergy guidance. In Fiscal 2017, we intend to deliver $158 million to $175 million cumulatively. That means the $60 million from the last year plus another $98 million to $115 million this fiscal year. Then, by the end of Fiscal 2018, we should deliver $225 million to $250 million of cumulative synergies.

With that, that concludes my prepared remarks and I'm happy to turn the call back over to Mark.

Mark Light:

Thank you, Michele. To sum up, we had a challenging quarter but we know why and we have sound plans to address it. We possess numerous competitive advantages and expect to strengthen our leading position and gain profitable market share. I want to thank all Signet team members for their hard work and dedication.

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.

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

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Simeon Siegel:

Thanks. Good morning guys.

Michele Santana:

Good morning, Simeon.

Simeon Siegel:

Can you quantify anything this quarter you view more as a one-time hit? Maybe tied to PR issues. You mentioned the reputation defense element and the adjusted SG&A build. How much was that? How much, if any, do you think continues of that long? Then, Michele, can you also just—in light of the comment you made, can you just talk to the ability to hit that Zale's mid- and long-term EBIT margin rate targets in light of the synergy comments despite the weaker sales? Thanks.

Michele Santana:

Sure. In terms of the one-time costs that impacted the second quarter, in my prepared comments I had indicated that was about $5 million, right? Close to about $0.05 of per share impact. There will still be some additional cost related to that in Q3 as we look in terms of training, some of the investments that we're making with in-store technology around this area that maybe Mark wants to speak a little bit more to, so I would anticipate there is about $3 million or so factored into our Q3 guidance associated with that. So before I answer your second question, Simeon, is there anything else you want to mention in terms of the investments in the store?

Mark Light:

Well, we've been selling—I've been selling jewelry my whole life, over 30 years, and the most important part of selling jewelry is trust. The system that we have in place is a multi-step process right now, which we have full confidence in that we're doing the right thing in that when we have a customer that comes in, we test the diamond in front of the customer, we map inclusions, we get sign-off, we ship the product to our shop, then we check it in and repeat the sign-offs and we check again to make sure that the diamond is real and we map it again. So, overwhelmingly, we feel that we have a great process in place to ensure that our customers are getting what they expected to get.

That being said, we're taking the opportunity to test in the fourth quarter some new technology that relates to specific gem scopes that we're putting in place in some of our Kay stores that will not only have a view of the product under magnification, but it will also have a digital screen on top of the gem scope that will highlight the unique marks of everybody's diamond. Every customer's diamond is like a thumbprint; they have all unique marks to it and we will mark those on a digital screen and then we'll have the ability to digitally send over that picture to our customers via email and keep it in our own files. So, we believe that by putting this type of new technology in place in our stores that we are enhancing and creating even more transparency for our customers and that it will be a huge competitive advantage for us into the future.

Michele Santana:

Then, Simeon, following up on your second question in terms of the long-term EBIT margin objectives that we have related to Zale and is there any impact that we see in a lower sales environment, again, Mark had mentioned in his prepared remarks when you look at the synergies that we have in place, and again, synergies are flowing throughout the organization, but the majority of those synergies are not

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contingent on the top line. They're really related to growth margin initiatives, SG&A control. So at this point, I feel confident in terms of our long-range goals as it relates to our Zale margins.

Simeon Siegel:

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

Michele Santana:

Thank you.

Mark Light:

Thank you.

Operator:

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

Oliver Chen:

Good morning. We had a question regarding Jared. Mark, in your prepared comments you mentioned the fundamental issues at Jared. What are your thoughts on how this is manifesting with traffic and conversion and what should we look for in the back half as we think about Jared and the initiatives that are taking place versus some of the issues you are pointing out around your work around customer and what you can do there?

Also, Mark, on Leonard Green, could you brief us on why this was the right time for this and which aspect of their retail expertise do you expect to benefit from most over time? Thank you.

Mark Light:

Thank you. The Jared fundamental issues, as I stated in my prepared comments, after reviewing and doing intense research on our Jared customer and understanding how that customer is segmented differently than our Kay or Zales stores, we focused on making sure that we understand that customer better and putting in the right products, having the right advertising communication vehicle, talking to those customers specifically and making sure that we do what they believe is the best for the Jared customer experience, so we think starting with the Chosen Diamond which we know is perfectly targeted to the Jared sentimentalist customer that tracks their Chosen entirely through the journey we think is going to be a tremendous enhancement to the Jared business in the fourth quarter. It's been testing very well, Oliver, and we continue to see enhancements in every store that continues to test the Chosen Diamond. We believe once we have that in all of our Jared stores for the fourth quarter, supported by a wonderful advertising television creative to really explain the journey of a diamond is going to be a huge enhancement to the Jared stores of the fourth quarter, and it talks specifically to the customer segmentation of that Jared customer.

We also have some initiatives that we have in place on enhancing our selling tactics. I'm making sure that a customer is taken care of from the minute they come in the door and not passed around to different departments while they're in the selling area. We're also testing certain—I mentioned this pricing tactics and I won't go into a lot of detail for competitive reasons. We have pricing tactics that we're testing right now that we think could be an enhancement for Jared for the fourth quarter. We're also very excited, and I mentioned this in my comments—we're very excited about the Jared store-in-store, the Jared Pandora boutiques. We have about 180 stores that have them up right now. They have an expanded assortment

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in Pandora jewelry. We have targeted training and a targeted sales associate is working just in the Pandora counter and we believe with that expansion of Pandora in our Jared stores and we'll be creating a specific creative for advertising to communicate to customers about the broad assortment that we have in our Jared stores of Pandora, we'll increase our foot traffic in the fourth quarter coming to those stores also.

So, we believe that we have some very good initiatives in the Jared store banners that tie specifically to the segmented customer that, quite frankly, we weren't doing a good job over the last couple of years on and we believe we have done a good job on that.

As far as the partnership with Leonard Green, Leonard Green is one of the foremost experts in the private equity world and investing in retail companies. They have a wealth of knowledge not only from the financial side but also from the retail experience of being on boards and working with other companies and we at Signet are looking very much toward having their guidance and getting their partnership with us and helping us determine ways that we can take this company going forward. We're looking forward to getting their insight and working through some of their partners and giving us some best practices that we can take out of Jared's, at Signet and enhance our business. The reason that the timing is perfect now is because, as I said in my prepared comments, our valuation is low and the idea of getting a company like Leonard Green who did a thorough due diligence of our business, of our practices, of our processes, just validates that Signet has a great business model and that Signet has some great growth prospects going forward and we believe that having Leonard Green on our board—or Mr. Sokoloff on our board, will continue to help us out going forward. We really excited, quite frankly, of having Leonard Green's input and insight on the important decision we're going to make as it relates to our credit strategy review.

So, that's just a few of the reasons why we believe Leonard Green is going to be a really exciting partner for Signet going forward.

Oliver Chen:

Thanks, Mark. Michele, on inventories, could you brief us on how they may trend in the back half versus sales? Mark, just sector-wise, you gave us a good briefing about the reality of the jewelry trends in terms of the market research out there. What do you think is happening with the market overall, just given that the state of the middle-income consumer seems okay? I'm curious about your hypothesis in terms of the industry at large, because it's been a resilient industry historically so this feels pretty new. Thanks.

Michele Santana:

I'll start with your inventory question Oliver. In terms of the back half of the year and how we looked at our inventory, first and foremost, we're very much focused on inventory optimization. That has been one of the key initiatives that it's related to. When we acquired Zale, we did see an opportunity to really optimize the inventory level through the merchandise assortment. So with that said, we're also acutely focused on the initiatives that we have in the back half of the year. All the great initiatives that Mark talked on the call in terms of with Jared, whether it's our Chosen, Pandora, Vera Wang, our Ever Us and product extension, so we're not going to starve ourselves. We have a great pipeline initiative so we'll balance our inventory and our working capital management of those inventory levels with a growth in those initiatives for Q4.

Mark Light:

Oliver, as you stated, the jewelry industry over years, years and years has been resilient and has grown over the last 10, 15, 20 years, 3% to 4%. There are quarters that will dip and it happens. In jewelry industry, we're not immune to economic issues out there. So, the industry has consistently performed and Signet has consistently outperformed for years the jewelry industry and retail as a whole. What we

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think is happening out there is, as we all know, there's a lot of questions out there, whether it be what's happening with the Brexit that we believe affected the mindset of people in Middle America across the country. There's things—obviously there's a presidential election, which is unique this year, and I think has some very unique characteristics that could be affecting the mindset of Middle America consumers until we get through this. Quite frankly, it's just something that's happened before and we think we're going to come out of it just fine. We just have to be focused on making sure we're doing what we know how to do best; just taking care of our customers and continuing to innovate and bring exciting new products to the consumers out there in our markets.

We believe there's something just going on maybe in a geopolitical perspective, but once we get through the elections, hopefully we'll see some stability and we'll recover like we have year-after-year over the past years.

Operator:

Your next question comes from the line of Brian Tunick with RBC Capital Markets. Your line is open.

Brian Tunick:

Thanks. Good morning. I guess two questions. One, regarding the quarterly flow of the business in Q2, just curious between the reputational attacks, which I guess were around June, and then the weakness in the energy market, just curious if you can maybe talk through what you saw between those two issues and how the business had trended throughout the quarter. Then Michele, on the $1.1 billion buyback program, how much is embedded in your updated earnings guidance? Should we expect that to be completed in a pretty short time, or is that going to be more into next year as well? Thanks very much.

Mark Light:

As far as the reputational issues that arose in late May, there were some negative media, social media perceptions of Kay in May and into June, but this completely normalizes—and we track this weekly—that the social media perceptions have completed normalized in July and into August. We measure—on a regular basis we look at our customer complaints, we look at social media and we had some lifts in the end of May and into June, but like I said, in July and into August it's all been normalized.

We've done several different surveys to make sure that we understand what the bad news and how the perceptions of our Kay brand were, and our Jared brand for that matter, and it's impossible to really know for sure if it's affected our sales or not but what we do know is that the surveys that we have taken, and there were some independent surveys done by some sell side analysts, all confirm that the Kay brand is still very well perceived by consumers, as is the Zales and Jared brand. Overall, the Kay brand is still in very good—the Kay brand equity is very strong as it ever has been.

We have—one thing you can look at, by the way, is our Kay brand actually did better compared to most of our banners. So we don't believe the publicity overhang is really affecting our business but it's hard to understand specifically if it is or is not. The surveys are a key indicator for us, and obviously sales are a key indicator for us.

Michele Santana:

In terms of your question on the share buyback with the 1.1 million, in Q2, what we had done is we accelerated our planned Q3 and Q4 share repurchases into Q2 given the opportunity that was presented on the share price value. Year-to-date, we have $375 million repurchased as I mentioned in the comments, Brian. That is what factored into our EPS guidance and roughly that's about $0.30 of the EPS, if you equate that.

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When you think about the transaction, as Mark had mentioned, the whole objective of the transaction from a financial standpoint is to be neutral. So we will repurchase 625 million—it will be 625 million of shares related to that and that would commence this year.

Brian Tunick:

Can I ask one final question? On the dollar earnings cut to the year, just curious, I mean Q4, are you embedding it seems like negative comps in Q4 for the earnings revision?

Michele Santana:

Yes, so obviously we didn't come out and give a Q4 guidance but it is implicit you could easily reverse engineer and get an idea of what the Q4 implied guidance would be. There is a negative comp in Q4, however we do anticipate that that would look a little bit more favorable in terms of Q3. If you go back and you look at our past five-year historical trend moving from Q3 to Q4, on average it's about 120 basis points acceleration between Q3 and Q4, which completely makes sense given it's a key holiday gift giving period. We're on TV at that time at least eight weeks out of the year. We would anticipate with all the initiatives to have some level of acceleration moving from Q3 to Q4.

Mark Light:

We know, to Michele's point, Brian—to Michele's point, we know, and we've studied this for years, that when we're on TV, we gain market share and we've seen this consistently over the last five years. Specifically, when we're on TV and Christmas where out weights are at the highest level that we really get involved in, we gain market share while we're on TV.

Brian Tunick:

Great. Thanks and good luck.

Michele Santana:

Thank you.

Operator:

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

Lorraine Hutchinson:

Thank you. Good morning. You called out bridal as soft for the first time in a while and I just wanted to ask if you thought this was a direct result of the unsubstantiated claims that you referenced? Also curious if you've seen any change in trend line in your repair revenue or warranty attachments? Thank you.

Mark Light:

Thank you Lorraine. It's hard to understand specifically, like I said earlier, that what's attached to the public relations issues and its effect on our business as a whole. We don't believe that it is the reason for our bridal not being as strong this quarter. If you look at some of our competitors that have talked about their bridal business, they've also had soft sales in the bridal area for this quarter. We believe it's something that is a consumer mindset issue that relates to bridal and that they just want to get some stability and understand what's going on as a whole in the world and what's going on in the presidential

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election. We don't believe and it's hard to determine that the bridal business not being as strong as it has been in the quarter is due to the public relations issues, but there's not direct correlation, there's no way we can completely measure it. Again, like I said, we've heard throughout the industry and we've seen other publicly traded jewelry chains, jewelry companies also have issues with bridal this last quarter.

Michele Santana:

In terms of, Lorraine, to your questions on repairs and warranty attachments, repairs, which Mark had mentioned in terms of synergies, is a key synergy particularly on the Zale side, so we actually have seen an increase related to our repair sales and related margin associated with that, not necessarily an increase in terms of repair claims.

As it relates to the warranty attachment rates, we do continue to see and uptick in terms of those customers who see the value in purchasing our extended service plan. That's primarily tied to, again, whether it's bridal or higher priced collections such as our higher diamond jewelry collections, which we indicated was a relatively strong performance for us in Q2.

Lorraine Hutchinson:

Thank you. I thought the new system sounded interesting where you mapped each person's diamond. Do you plan to market this to your customers?

Mark Light:

We first need to get it in the stores. We actually created this ourselves internally so we're working with several vendors and working with our IT Department and our Purchasing Department and Operations Department. We've first got to get it in the field and test it out, so we'll have it out in many stores this fourth quarter, and if it's going to be successful as we think it is, we may see an opportunity to market it. We see it, like I said Lorraine, that this could be a huge competitive advantage that the Signet stores can have this technology that opens up transparency to our customers, that engages them to even be more trusting of our people and our brands. So, first of all, we need to test it this fourth quarter but we will have it in hundreds of stores and with the hopes that it will be successful and be able to take it to all of our stores next year. We will market it, if it's appropriate, and we will wait and see.

Operator:

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

Paul Lejuez:

Thanks guys. Just curious, when did you first start to see the energy markets weaken relative to the rest of the chain? I'm curious if you have any specific different plan of attack there to address the weakness in those markets? Thanks.

Michele Santana:

Yes, so Paul, it's Michele. Let me talk to you just in terms of overall when we started to see these trends. Actually if you go back to even Q3, we did start to see some trends in the energy-reliant regions. Now that was predominately up in Western Canada, the Alberta region. In Q4, we started to see a little more of a pronounced impact, started to see a little bit happening more in the Texas region. Q1, again that trend continued and we started to see it probably spread into a few more states on how we define that energy-reliant region, but I would say most notably as we shifted from Q1 into Q2, you really did see an

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acceleration in terms of those states or those oil-reliant regions having an impact on our comp sales. It's been an acceleration from Q3 last year to Q2 of this year.

Mark Light:

As far as targeting those markets with certain promotions or programs, there's a fine balance here, Paul, that we have to take because when you have a market that's just not doing well with relative to macroeconomic issues, you don't want to just lower your margins and increase your promoting and just give away margins obviously or give away gross margin dollars. We are testing and looking to see where we can find that fine balance in these specific markets, and we'll look to see if there are some programs that we think will be beneficial, but we've got to balance out to make sure that we understand that sometimes you just can't push water uphill and you don't want to just give away gross margin dollars. We're looking at it, we're testing some options but we're going to be balanced on that front.

Paul Lejuez:

Got it. Then just one follow-up. There was a change in your average transaction value in a couple of brands. Is that a function strictly of slowing bridal/engagement jewelry or was there something else that impacted that? Was there just a higher level of promotions across the board?

Michele Santana:

Yes, so in terms of the ATV on what you're referencing as the decline, that was—I'd say it was driven by a couple of things. It was the relative strength that the fashion jewelry gained over bridal is one element of it. Not so much I'd say on the promotional side, we saw that in Q1, we talked about Q1 in terms of the promotional in advance of the Mother's Day, but it's primarily merchandise mix driven.

Paul Lejuez:

Thanks. Good luck, guys.

Michele Santana:

Thank you.

Operator:

The last call there is time for comes from line of Ike Boruchow with Wells Fargo. Your line is open.

Ike Boruchow:

Hi everyone. Good morning. Thanks for taking my question.

Michele Santana:

Morning Ike.

Ike Boruchow:

I guess Michele, you talked about Q4 basically kind of implying a little bit of negative comp but earnings growth. I'm not looking for guidance or anything, I'm just kind of curious, because of the Zale synergies and the buyback and the cost opportunities, if we looked into next year and let's—just to be conservative if we assumed that comps kind of remained in slightly negative territory—could you still grow the bottom

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line in that kind of environment in your next fiscal year? I'm just kind of curious how you would talk about that.

Michele Santana:

So Ike, and as you well said, we're not going to obviously guide into next year. I mean we're absolutely focused on Q4 this year and meeting the guidance that we've issued. With that said, we have strong synergy flow-through and there are additional synergies that we would achieve next year that would favorably impact our operating income, combined with just our continued focus on cost control and savings. Outside of that I'm not going to entertain trying to get guidance for next year.

Ike Boruchow:

Okay. Then just a quick follow-up. I think, Mark, you commented about revamping and expanding the credit reporting. Is that something that we should look for next time you report or in the 10-Q when that gets filed. I'm just kind of curious if you can elaborate on that?

Michele Santana:

I'm going to jump in here on that one, if you don't mind. The comments that we have referenced is that when we look at our credit strategic review, there really are two positions, two sides that we could be in. It's either optimizing our current portfolio, and in the case optimization we will enhance our disclosures in the Q which include a number of elements. So it is when we make that decision, as we move through and get to the completion of that review, that's when you would anticipate to see enhanced disclosures related to the credit portfolio.

Ike Boruchow:

Got it. Thank you.

Michele Santana:

You're welcome.

Mark Light:

Thank you. Thank you all for taking part in this call. Our next earnings call is scheduled for November 22. Thanks again to everyone and good-bye.

Operator:

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

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