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Signet Jewelers Ltd. (SIG)

Q3 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Signet Jewelers Limited Q3 Fiscal 2018 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. [Operator Instructions] Please note that this call is being recorded today, November 21, 2017, at 8:30 AM Eastern Time.

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

James M. Grant

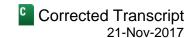
Vice President-Investor Relations, Signet Jewelers Ltd.

Good morning and welcome to our third quarter earnings conference call. On our call today are Signet's CEO; Gina Drosos; and CFO, Michele Santana. The presentation deck that we will be referencing is available under the Investors section of our website, signetjewelers.com.

During today's presentation, we will, in places, 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 our Annual Report on Form 10-K. And we also draw your attention to slide number 2 in today's presentation for additional information about forward-looking statements and non-GAAP measures.

I will now turn the call over to Gina.

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Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

Thank you, James. Good morning, everyone, and thank you for joining today's call. Today, Michele and I will discuss Signet's third quarter results, provide an update on the progress we're making on our strategic initiative, share insight into our plans for the holiday selling season, and provide a detailed update on our credit transition, then we will open the line for your questions.

Beginning with the third quarter results we reported this morning. Signet had a challenging third quarter. We experienced a sequential decline in our comp sales, which was largely anticipated in, what is our smallest quarter, with an absence of gift-giving holidays. We also faced headwinds from weather-related incidents and disruptions in our systems and processes during our credit outsourcing transition. These events further pressured our results and impacted our comp sales by 60 basis points each. I'll discuss credit in more detail in a few minutes.

Lower sales on fixed costs and the inclusion of R2Net, which has a different business model and carries lower margins, resulted in a decline of 170 basis points in our gross margin. However, excluding R2Net, we delivered higher gross merchandise margins despite a heavily promotional environment. We saw improved effectiveness from our streamlined promotional strategies and sharper customer targeting. We also continued to focus on cost control. We reduced expenses and improved our SG&A rate by 10 basis points despite the 70 basis point unfavorable impact of R2Net transaction costs.

In total, for the third quarter, we recorded a loss of \$0.20 per share, including transaction costs of \$0.25 and a \$0.10 negative impact of the weather- and credit-related events that I mentioned moments ago. As you can see, \$0.35 of the loss was related to transactions, weather and credit disruption.

Importantly, I'm encouraged that we advanced our strategic initiatives during the quarter, and they are beginning to deliver tangible results that I'll discuss in detail in a few minutes. But first, I'd like to take a moment to provide more insight into our credit outsourcing transition.

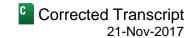
As you know, in October, we completed the first phase of strategic outsourcing of our credit portfolio to Alliance Data and Genesis Financial Solutions. This was the right strategic decision for Signet as it allows us to de-risk our balance sheet, streamline our organizational and capital structure and place a greater focus on what we do best, delivering an outstanding OmniChannel jewelry shopping experience for our customers.

This was a very complex transaction, involving over 2 million credit accounts. And therefore, execution of the transition has been a priority for us since we announced the transaction in May. We have had a multi-functional team working in concert with our new partners, testing systems and working through all aspects of the transition.

Unfortunately, we experienced significant executional disruptions related to the transition. These were primarily related to the conversion of IT systems and the magnitude of in-store process changes related to the new program. And in the first several weeks, the issues had a compounding impact.

For example, server interruptions and downtime resulted in an overwhelming number of calls to our partners' customer service centers, leading to extraordinarily long wait times. This resulted in a suboptimal credit experience for our store consultants and customers. We have been working with urgency to resolve these issues. We're confident that we've fixed the critical majority of the systems issues and our internal process metrics have improved in recent weeks. However, we haven't seen a full recovery yet, and so we expect credit sales to continue to be impacted in Q4, negatively affecting our fiscal 2018 guidance.

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I want to assure you that the credit situation has the full attention of our leadership team, partners and team members and will remain one of my personal top priorities until the entire issue has been resolved. This level of disruption to our customer service is unacceptable. We will remain resolutely focused on improving the reliability of our operations to be able to drive sustainable and predictable growth at Signet.

Finally, on the positive side of credit, I will note that we are in advanced discussions with potential buyers for the remainder of our credit portfolio and are increasingly confident that Phase 2 will be completed in the first half of 2018.

Now, moving to slide 4. As I communicated previously, we are focused on three key strategic priorities to improve Signet's competitive advantage: Customer First, OmniChannel and building a Culture of Agility and Efficiency. We achieved some early wins during the third quarter across these three pillars, which I will discuss on the next slide.

Starting with Customer First. Having spent almost my entire career in the consumer sector, I'm acutely aware that the backbone of a customer-driven organization like ours is a deep understanding of what the consumer wants. This is particularly important for Signet as we engage with consumers to help them celebrate the most memorable moments in their lives.

Over the last year, we've tested a number of promotional strategies and heard loudly and clearly that our customers want simpler, focused offers. We successfully implemented these strategies around Labor Day and our October bridal event, which resonated well with our customers, and we aligned our plan accordingly heading into the holiday season. We strengthened our competitive positioning in the fashion category with an enhanced assortment at key price points and saw improving results in these updated collections.

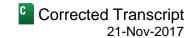
Next, we significantly ramped up our digital and social media efforts, which has high influence with our target audiences. We are now active on all six of the most popular social media platforms, and we more than doubled our impressions year-to-date reaching nearly 1 billion impressions and will continue to build on this growth. We also launched our first-ever influencer campaign in Q3, which we are extending to over 100 influencers in Q4 from whom we expect over 100 million impressions.

Our social media efforts are proving highly effective, with three times the number of impressions per invested dollar than traditional media, while allowing us to deliver more targeted and personalized messages. We're reaching people five times more likely to be married soon than through traditional marketing efforts.

To further accelerate our focus on the consumer, we've been making investments in advanced data science and analytics. A great example is the data management platform we launched in October. This system allows us to identify fashion and bridal customers and analyze their prior activity on our websites, so we can better target them and enhance their shopping experience. Taking this information, we are now delivering personalized content on our websites, providing smarter browsing and pairing recommendations and customizing our marketing messages to better align with customers' personal journeys.

To put it into perspective, last year less than 3% of our customers were served a personalized page on arrival to our websites. This year it will be around 20%. We are already seeing double-digit improvement in our conversion metrics. We've also taken an important step to build our first-ever customer data analytics team of data scientists and hired a new executive leader in Q3. This team will focus on deeper customer insights and engagements to drive our Customer First priorities.

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Moving to OmniChannel. As you know, we've been working tirelessly since last year to improve our eCommerce capabilities. In Q3, we added several important functionalities to our Sterling websites, to better integrate the store experience with online. These include the ability to search for inventory in local stores; online appointment booking to meet with a diamond consultant in a store; a proactive live chat functionality; and the OmniChannel bag, which sinks the products customers add to their cart online or view in-store into one virtual shopping bag that can be accessed anywhere.

The enhancements we made on our OmniChannel platforms, combined with the acquisition of R2Net, resulted in 56% eCommerce sales growth in the quarter. On the Zale side, we upgraded our eCommerce sites to the new hybris platform, which has a more user-friendly design and functionality. We experienced some expected conversion in SEO issues during the launch, but traffic has rebounded coming out of the quarter.

The website is now functioning at improved speed and performance and is ready for the holidays. We've already seen our key metrics ahead of the same period last year, including conversion up 11% and traffic up 21%. As you know, we recently completed the strategic acquisition of R2Net. The transaction enabled us to rapidly enhance our digital technology capabilities. We have already started to implement a number of synergies.

Starting with the high-quality diamond imagery and content technology, we're building a Segoma diamond photography center in Akron, scheduled to start production in Q4. We are also installing retina display screens in select Jared stores, dedicated to showcasing this technology. The diamonds are all photographed in stunning 360-degree high-definition and 40 times magnification, allowing our customers to truly see each and every detail in the diamond they're purchasing.

Next, we rolled out an impressive diamond [ph] consul (12:37) technology on our Jared Design-a-Ring platform this month available online 24/7 to offer real-time diamond consultation to customers, including the ability to share their screens and provide expert guidance on everything from the specs to the grading certificate.

Finally, we're uniquely styling R2Net's Ring Try-on App for Kay. The ability to virtually try on and experience the rings on your mobile phone as if they were on your finger, will inject more fun into the jewelry shopping journey. Beyond Q4, we are already working on a number of projects to further leverage R2Net's technology and innovation capabilities.

Finally, I will talk about some results on building a Culture of Agility and Efficiency. As I mentioned last quarter, we are executing on several productivity initiatives. In fiscal 2018, we drove expense reductions related to corporate overhead as well as from advertising expense associated with a shift from traditional to higher ROI digital advertising. We have nearly completed the consolidation of our distribution centers to service all of our U.S. store brands from Akron. This new and upgraded facility will position us for growth, expanding capacity to three times prior levels upon completion and will reduce our distribution costs by 13% over the next two years.

We're also exploring ways to simplify and streamline our processes to drive faster and more efficient execution. For example, during Q3 we streamlined the responsibilities of our store associates, releasing over 80,000 hours per month from administrative tasks that can be reinvested in customer service and training.

On the next slide I will briefly discuss our holiday initiatives. First, we fully analyzed last year's holiday performance and addressed the gaps which we estimate accounted for approximately 400 basis points of the comp decline in Q4 of last year. That is the estimated combined impact of lost eCommerce business as well as business to the stores.

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As I mentioned, we made important enhancements to our Sterling eCommerce platforms and are pleased to see that our efforts have been paying off, evident from the 34% year-over-year growth we delivered in Q3. Another miss we had last year was our fashion assortment in the \$200 to \$700 price range, which we strengthened this year and has already shown positive results for Q3.

We introduced our new Interwoven collection earlier this month, which is targeted for the gifter, especially younger couples. It is a beautiful diamond collection that symbolizes two lives Interwoven to become one with a single diamond. We launched with a 36-item assortment, most of which are below the \$1,000 price point together with a digital-led marketing campaign.

This new collection works well with the stacking and layering trend, which is currently one of the hottest trends in jewelry. Capitalizing on this trend, we added one to two display cases in each of our North American stores devoted to stacking and layering and have been expanding our assortments throughout October and November.

We also expanded assortments in our exclusive collections with new colors, shapes and sizes. I'll highlight a few that we're very excited about. We have been testing Disney Enchanted bridal and fashion exclusives in our Zale division since last spring. And based on strong feedback from our customers, we expanded the distribution to all Zales and Peoples stores.

In Vera Wang, we are driving newness and shapes and colors in the engagement category and expanded the fashion line to more stores with a greater assortment. We also added beautiful new items to our LeVian collection, another Jared exclusive that comes in unique color gems and styles.

Another new collection we are excited about is Emmy London that launched last month at Kay, with a 50-item assortment at price points that range from \$60 to \$2,000. Emmy Scarterfield is an accomplished luxury British shoe designer best known for her inspired bridal and special occasion styles. With these initiatives and more, our fashion assortment this year contains over 50% new items this year versus last year.

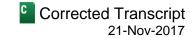
Our bridal offer also remains comprehensive and highly compelling. Product and pricing tests during the summer have led to line extensions, more solitaire designs, additional carat weights and fancy shapes and the continual development of our key brands, as I mentioned.

Moving to marketing and promotions. We will have a simpler and more focused marketing strategy this holiday. This applies to both our promotional offers, which will be consistent for longer periods of time and a number of ads we will have on TV. We nearly halved the number of TV commercials for the holiday season and are focused on brand equity building instead of purely promotions.

We also continue to better integrate our messaging across channels and shift our marketing dollars to digital from traditional. In fact, our digital marketing spend in Q4 of this year will make up nearly 30% of our overall spend compared to only 19% last year. And finally, we are increasing our focus on targeting her and millennial consumers in addition to him.

We added female and millennial-focused content in our ads and realigned the scheduling of TV commercials. The robust digital and social media plan I discussed earlier also supports our enhanced reach among these key demographics. This is a strong and much improved plan for the holidays to help our customers celebrate this exciting season.

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Before I turn it over to Michele to provide more details on our Q3 performance and fiscal year outlook, I'd like to reiterate a few key points. We are aggressively transforming this company. We completed two strategic and complex transactions during the third quarter: the acquisition of R2Net and the first phase of our credit outsourcing.

On Customer First, OmniChannel and our Culture, we delivered a number of very important wins. We significantly improved our eCommerce sales, made critical shifts in our digital marketing, data analytics and targeting, and added numerous new features in our websites to connect with our in-store experience. We also implemented some important R2Net synergies ahead of plan.

Yet on the credit transaction, it's clear that our change management processes weren't fully ready to absorb this level of complexity. And while the identified systems issues are behind us, the process changes are still cycling through our field operations and will take some time to be fully absorbed. I'm disappointed that we underestimated the magnitude of this change. But we will keep working tirelessly to handle issues and learn from this, as we continue to drive needed transformation of Signet.

I and Signet's leadership team are committed to drive all changes necessary; strategic, cultural and executional, to deliver stronger and more reliable results going forward. This will take time and we have more work to do. However, we believe we are on the right track to create a more competitive Signet that is positioned for sustainable, profitable growth.

Michele?

Michele Santana

Chief Financial Officer, Signet Jewelers Ltd.

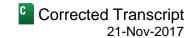
Thank you, Gina. For the third quarter, Signet's total sales were \$1.2 billion, down 2.5% year-over-year or 2.8% on a constant currency basis. Comp sales decreased 5% compared to a decline of 2% in the prior-year period. The acquisition of R2Net contributed 40 basis points of favorability to comp sales, while an estimated 120 basis points of negative impact was attributed to adverse weather and disruptions in our systems and processes associated with the credit outsourcing transition that occurred in mid-October.

From a banner perspective, across the majority of banners, higher-average transaction values were more than offset by a decline in the number of transactions. However, in Kay we did see both a decline in ATV and the number of transactions due primarily to bridal and in part due to the impact of credit disruption.

In looking at category performance, fashion jewelry in select categories and key price points performed well with some encouraging signs from the newness in our assortment. Bridal is challenged during the quarter, particularly in our Kay banner as I just mentioned, and it was disproportionately impacted by the issues related to the credit transition that launched a week later than our three-week October bridal promotion.

October was a strong performance period for our Zale banner, who exited the quarter on positive comps. On a channel basis, eCommerce sales grew 56% over last year and represented 7% of total sales compared to 4.4% in the prior year, primarily driven by the recent acquisition of R2Net. Excluding the 47 days of sales related to R2Net, eCommerce growth was 10.5% and represented 5% of sales. We saw strong growth in our Kay and Jared digital sales, driven by the number of enhancements we have made to our sites combined with investments in digital marketing.

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As Gina mentioned, eCommerce performance for Zale was affected by the transition to the new hybris platform. This new technology has replaced previous website architecture with a more user-friendly interface, enhanced features and improved functionality. As is the case with any website relaunch, we experienced a post-implementation decrease in traffic during the third quarter following the change. As we head into the holiday season, recent trends have shown that traffic and conversion have resumed to the levels that we would expect to see.

So moving on to the income statement. For the quarter, gross margin was \$321.1 million or 27.8% of sales. The decline of 170 basis points includes 30 basis points of de-leverage related to R2Net, who carries a lower gross margin rate. The residual decline of 140 basis points in gross margin is attributed to lower sales leading to deleverage on fixed costs, higher inventory disposition costs associated with the distribution center consolidation, and offset in part by higher growth merchandise margin rate and lower bad debt expense. The lower bad debt expense rate is attributed to the decline in our receivables portfolio associated with the sale of our prime accounts.

SG&A expense was \$375.9 million or 32.5% of sales, and that compares to \$386.6 million or 32.6% of sales in the prior-year quarter. Total SG&A declined by \$10.6 million or 2.7% over prior year and leveraged 10 basis points in rate. SG&A includes \$8.1 million of transaction-related costs associated with the R2Net acquisition, which unfavorably impacted the SG&A rate by 70 basis points. Excluding these transaction costs, the SG&A rate would have been 31.8%, which includes 30 basis points of leverage related to R2Net who has a lower SG&A rate.

Further, as previously communicated, we remain focused on streamlining our organization and optimizing our cost structure. In the quarter, we continue to realize cost savings from payroll and payroll-related benefits in both stores and corporate, including a \$4 million non-cash gain related to curtailment of our U.K. pension plan as well as other select corporate expenses.

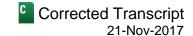
Additionally, we continue to enhance our marketing efforts with higher-return investments through an increased mix of digital advertisements, with a more prudent spending through traditional channels. This mix in marketing efforts has resulted in efficient spend and savings.

Upon the close of the credit transaction with Alliance Data Systems or ADS, we've recognized a \$10.2 million pretax non-cash gain, reflecting the future profit sharing agreement on the receivable balances sold to ADS in the third quarter. In addition, \$22.4 million of credit transaction cost related to legal, advisory, implementation and retention expenses, were also recognized.

On a net basis, the aggregate of the two items unfavorably impacted operating income by \$12.2 million and margin rate by 110 basis points. Other operating income was \$72.5 million, a \$3.9 million increase over prior year. Operating margins declined 220 basis points, which includes a 170 basis point unfavorable impact related to the net credit transaction cost of \$12.2 million and the R2Net transaction cost of \$8.1 million. R2Net virtually had no impact on operating margin rate.

The third quarter included an income tax benefit of \$7.2 million compared to a \$2.4 million expense in the prior year. The benefit for the third quarter represents the adjustment required to provide for taxes at the expected annual effective tax rate of 22%. We reported a loss per share of \$0.20 compared to earnings of \$0.20 in the same quarter last year. The quarter included a \$0.25 loss related to the net credit transaction costs and the R2Net transaction costs.

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In addition, the combination of weather impact and credit disruption negatively impacted our earnings per share by an estimated \$0.10. Note that in Q3 we utilized our basic share count to calculate EPS in the third quarter.

So, turning to working capital and free cash flow. We continued to drive improvements in working capital during the quarter. We ended the third quarter with \$2.5 billion in net inventory, which is down 6.9% year-over-year. Reductions in inventory continue to be driven in our Zale division by continued enhancements in how we manage Zale stores, carrying less product per store and focusing on [ph] displace (28:39) of our most successful collections.

We continue to view inventory levels as an area of opportunity to further drive working capital efficiencies. At the end of our quarter, net accounts receivable was \$640 million compared to \$1.6 billion last year, reflecting the sale of our prime receivables of \$960 million to ADS. I'll share further details on portfolio key metrics momentarily.

The proceeds of \$960 million received from ADS were used to fully repay the \$600 million ADS facility and \$350 million short-term bridge loan that was used upon the acquisition of R2Net. We ended the quarter with \$256 million borrowed on our revolver and \$732 million in debt related to our term loan and senior unsecured notes.

Free cash flow generated in the year-to-date period was \$1.3 billion compared to a \$165 million in the prior year. Excluding the proceeds received on a partial sale of our receivable portfolio, free cash flow was up nearly \$200 million over last year. The increase was driven primarily by working capital efficiencies through inventory reductions as I just previously discussed, and lower capital spend year-over-year. In the quarter, no share repurchases were completed, however, year-to-date we have repurchased 12% of our shares.

So moving on to our credit portfolio on slide 9. Our third quarter credit sales in the Sterling division were \$402 million, a decrease of 15.3% over prior year. Credit participation was 59.6%, down 7.2 percentage points from prior year. Similar to our second quarter, we continue to see a decline in the application volume of approximately 15%, thereby resulting in a lower number of approved applications.

Prior to the mid-October credit conversion, our credit penetration rate was running about 300 basis points unfavorable to the prior year as a result of lower applications. Additionally, October applications were negatively impacted by technical interruptions as well as process change associated with the credit transition, as store personnel work to become more accustomed to the new procedures.

As I mentioned, we ended the quarter with overall receivables substantially down from the prior year due to the sale of our prime receivables. The average monthly payment collection rate for the third quarter was 10.2% compared to 10.6% last year. The decline in collection rate is primarily the function of increased usage of extended payment credit plans, resulting in lower required schedule payments.

Interest income from finance charges which makes up virtually all of our other operating income on our income statement was \$70 million, an increase of \$3 million or 4% compared to the prior-year period. Net bad debt expense was approximately \$52 million or \$5 million lower than last year, attributed to lower ending receivables. And when taken together with finance income, generated an operating profit of \$80 million. The net combination was up \$8 million versus last year. The allowance related to the residual part of our credit portfolio not sold was \$109 million or 15.3% of gross receivables.

For comparative purposes, had the portfolio been bifurcated in the same manner in the prior year, the residual receivables would have totaled \$714 million, with an allowance of \$111 million or 15.5% of gross receivables in

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the third quarter last year. As it relates to residual back book, we're very pleased with the progress related to Phase 2 that includes the sale of this portfolio.

Also in June, we had fully rolled out our merchandise leasing program to all U.S. store banners. We are still early in the implementation of this new program and are focused on execution and adoption across all banners. Lease sales for the quarter were \$16 million and continue to grow gradually as a percent of all tenders.

As we had previously noted, effective with Q4 and through the end of the year, we'll only underwrite about 50% of our lowest tier accounts that represented 7% of total Sterling credit sales and expect leasing sales to replace this population. In addition, we are no longer underwriting credit insurance as a result of the credit transaction.

So now turning our attention to guidance. As we think about the fourth quarter of 2018 versus the fourth quarter of 2017, we have worked diligently to fix the issues that negatively impacted results during the holidays last year. As Gina had detailed, we've invested in our eCommerce platforms to improve stability as well as the user experience and will have an exciting assortment in the important \$200 to \$700 fashion price range.

However, the disruptions related to the outsourcing of our credit portfolio have impacted our view for the year. We have revised our fiscal 2018 outlook and now expect same-store sales to be down mid single-digit and earnings per share in the range of \$6.10 to \$6.50, with the low-end assuming no improvement in our credit performance.

As Gina mentioned, we have resolved the critical majority of the technical issues that impacted our ability to extend credit, but will continue to be impacted by process and change management-related issues, particularly in Kay that will take longer to resolve. We expect our Q4 results to be impacted by this transition.

So where we had previously expected Q4 to result in a positive comp, we now believe that comps may be down low- to mid-single digits and Q4 earnings per share to be \$3.86 to \$4.28. [ph] To also further assess you (34:56) a model in Q4, we expect gross margins to be relatively flat due to the inclusion of R2Net, and SG&A to de-lever over prior year due to lower sales.

I also remind you that Q4 operating income, as guided, includes the net impact of credit outsourcing of \$22 million or \$0.16 per share dilution which consists of the elimination of bad debt, late fee income, finance charge income, SG&A savings and net servicing costs. We anticipate no further transaction costs to be incurred in Q4.

Due to profit shift mix, we are updating our effective tax rate for fiscal 2018 to 22%. Our weighted average share count will drop materially by the year-end due to the Q2 share repurchases of 8.1 million shares, and our CapEx and square footage guidance is slightly lower than previously guided.

And with that, I'll open up the line for your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Simeon Siegel with Nomura/Instinet. Your line is open. Simeon Avram Siegel Analyst, Nomura/Instinet Thanks. Hi. Good morning, guys. Virginia C. Drosos Chief Executive Officer & Director, Signet Jewelers Ltd. Good morning. Simeon Avram Siegel Analyst, Nomura/Instinet Can you elaborate a little bit more, Gina, on the credit transition – sorry, credit transition issues? I know you mentioned wait times. Were more people rejected? They just walk out the door before finding out, so any color

there?

And then you're obviously making a lot of changes. This quarter you called out credit [ph] at the D.C., Zales eCom, (36:42) et cetera. Just given the changes generally bring about disruption which we're seeing, what do we need to think about for next year? Thanks.

Virginia C. Drosos Chief Executive Officer & Director, Signet Jewelers Ltd.

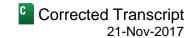
Sure. Thanks, Simeon. So let me start with credit. So we're all disappointed that this didn't go more smoothly and have all hands on deck working on it within our multi-functional team, our leadership team and partnered with our customers. And the disruption that we've experienced can largely be characterized into two buckets: technology issues and process and change management.

So, I'll give you some examples starting with technology. In the last week of Q3 and the first week of Q4, so – in the first two weeks of Q4, so our first three weekends of the transaction we experienced slowdowns or outages on servers each due to different causes that had discrete negative impacts on sales. We have fixed each one of those.

But in the meantime, we saw longer-than-usual new application process times and slow account lookups which frustrated customers and did cause some customers to abandon the application process. It also led to a suboptimal experience for our store associates, which has caused our store associates to question how quickly they can process credit applications. So these process issues, we believe, will take longer the normalized, but we will continue to make this a top priority until all the issues are resolved.

In terms of overall transitions, here's what I would say. The execution issues around credit have been related to specific credit systems and processes, and the huge amount of change management that we were undertaking. I think we've learned a lot from this. And it is absolutely a key priority for us to capture those learnings, so that as we move forward on additional transformation that we bring to Signet, we will do that with an eye toward training,

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toward fully understanding all of the impacts throughout our organization and how we work with our partners in an even better and more upfront way to anticipate any issues.

So we'll be undergoing a full post-transition review and we are committed to building a culture of agility and efficiency and continual learning that will help us to transform this company very successfully as we move ahead.

Simeon Avram Siegel

Analyst, Nomura/Instinet

Great. Thanks. And then either Gina or Michele, you did call out positive merch margins despite the comp pressures. Any color you can give there in terms of your expectations for maybe the competitive landscape and your ability to continue or how you view the merch margin trajectory?

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

So we expect the competitive landscape to remain highly promotional during the holiday season. The great news is that we got out in front of learning about how to optimize our promotional offerings and how to target those promotions to customers more effectively. And so, we've been able to be competitive in this highly promotional environment, but still improve our gross merchandise margins.

Simeon Avram Siegel

Analyst, Nomura/Instinet

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

Michele Santana

Chief Financial Officer, Signet Jewelers Ltd.

Thank you.

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

Thank you.

Operator: Your next question comes from Lorraine Hutchinson of Bank of America Merrill Lynch. Your line is open.

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

Hi, Lorraine. Lorraine?

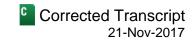
Operator: Ms. Hutchinson...

Stephen Albert

Analyst, Bank of America Merrill Lynch

Sorry, I was on mute. This is Stephen Albert on for Lorraine. I just had a quick couple follow ups on the credit disruption. So how confident are you that the disruption that you're experiencing quarter-to-date is done by the end of 4Q?

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And then, I guess, just to clarify. Since this credit servicing functions on the non-prime book have already been outsourced to Genesis, is this a one-time disruption or would you expect maybe some similar disruption in processes when you outsource subprime book in the first half of next year? Thanks.

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

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So as I said, we have all hands on deck on this credit transition. Our partners, our leadership team, our team members are working through all the issues that we've identified to date. We've been having daily calls and we are systematically fixing issues every day as we go. And so, we have rapidly responded to each issue as we have uncovered it.

The fact is, we don't know what we don't know and there are also process and behavior-related issues that may take longer to resolve. So for now we know that our Q4 performance will be impacted, so we're being prudent and revising our guidance for the full year.

Michele Santana

Chief Financial Officer, Signet Jewelers Ltd.



Yeah. And I guess in terms of your second question which I believe was, could we see maybe something similar when we close out Phase 2 of the outsourcing on the residual book and underwriting of the forward funding for those receivables. And what I would say is, one, first I would start with that. We're very pleased and we are making great progress as it relates to Phase 2. We are very much in advance discussions with our potential funding partners and feel very confident in terms of being able to complete this in the first half.

A lot of the more complex heavy lifting is done as part of Phase 1. There will still be work that we need to do in Phase 2. And I think going back to Gina's earlier comments, definitely lessons learned in terms of change management, process changes, will be utilized to ensure that we have a much smoother transition as we look to Phase 2.

Operator: Your next question comes from Brian Tunick of RBC. Your line is open.

Brian Jay Tunick

Analyst, RBC Capital Markets LLC



Thanks. Good morning. I guess, wanted to understand a little on the Zale comments you made. Obviously, understanding it didn't have any credit disruption. Just curious what you saw in the quarter. Obviously, you're commenting about, I think, positive comps coming out of October. So wanted to hear your thoughts about the Zale performance opportunities. Could they even get better into the holiday quarter?

And then back to Kay, just your confidence now in Progressive, I guess, ramping up to take that 7% of the underwriting that you guys won't be doing this year. Just what's your confidence that Progressive will step up for that number? Thank you very much.

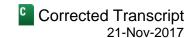
Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.



So starting with your question about Zale, we're seeing strong performance in our Zale division which, as you said, has not been impacted by the credit transition. So we saw sequential run rate improvement at Zale from September to October, driven primarily by bridal sales as well as eCommerce. Fashion also ended the quarter

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with a strong trajectory and we have seen strengths continue into November, where our run rates on Zale are very positive. We're very excited about the Disney collection and the exclusive items we have on that. We're doing great on solitaires. Piercing Pagoda is off to a terrific start on gold, which is a major trend for this holiday season.

So in a place where we were purely able to implement all of the strategic initiatives that we've talked about which is getting eCommerce to a great place, getting our fashion assortment aligned, strengthening our bridal, we're really seeing that pay off in work. So, we're very excited about the progress to date on Zale.

In terms of leasing, just as a reminder of leasing, when people apply for credit, we decline about 45% of those customers. And so, we are able then now in a way that we weren't before to offer them a new financing alternative, which is leasing. It's a new muscle. We didn't ever do that before. And so, our team is learning how to present multiple finance options, but we're seeing good pickup of that. We're seeing in the 20% to 25% range of pickup on the leasing and it is improving quarter-on-quarter. So, we are continuing to be able to leverage that as a new and strong financing option for our customers.

| Michele Santana Chief Financial Officer, Signet Jewelers Ltd. | A |
|--|-------------------------|
| Yeah. And I would just also add that we're gradually pulling back on that bottom 7% about for the holiday period. So think of it about 50% of that. So with that and combine Gina said, I feel fairly confident that we can cover that population. | • |
| Brian Jay Tunick Analyst, RBC Capital Markets LLC | Q |
| Great. Thanks and good luck for improved performance. | |
| Virginia C. Drosos Chief Executive Officer & Director, Signet Jewelers Ltd. Thank you. | A |
| Operator: Your next question comes from Lindsay Drucker-Mann of Goldman Sac | chs. Your line is open. |
| Bill Schultz Analyst, Goldman Sachs & Co. LLC Hi, everyone. This is Bill Schultz on for Lindsay. | Q |
| Virginia C. Drosos Chief Executive Officer & Director, Signet Jewelers Ltd. Hi, Bill. | A |
| Bill Schultz Analyst, Goldman Sachs & Co. LLC | Q |

Just had a question for you guys. I wanted to sort of leapfrog to Simeon's question on merchandise margins. I think you called out, excluding R2Net, the underlying merch margins were up in the quarter. What are the drivers of that? Was it a function of a mixed shift away from bridal in the quarter?

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And sort of second question is, your inventories look pretty lean exiting the quarter. Do you anticipate a continued improvement in merch margins [indiscernible] (46:48)? Thanks.

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

A

Yeah. So, let me take your question on the merch margins in terms of what some of those drivers were during the quarter. I'd say, it's a combination of items. Definitely, there was a favorable impact with mix. The other item I would add is, particularly we see on the Zale side, the synergies.

If you recall, the synergies that we're looking to achieve this year, a substantial portion of them resulted or related in terms of our gross merchandise margins, whether it's sourcing-related, discounting controls, et cetera. So it's the combination of those items that's driving favorability in the merch margins.

And then your second question was related to inventory level?

Bill Schultz

Analyst, Goldman Sachs & Co. LLC

Yeah, correct.

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.



Yeah. I would say that's an area that I've been very excited about, because I think – I continue to see opportunity to optimize the inventory levels. And when you start thinking about technology, particularly with the R2Net and technology that we can start to deliver into our stores, I think it just enhances the opportunity we have to further optimize working capital, particularly related to inventory.

Bill Schultz

Analyst, Goldman Sachs & Co. LLC



Thanks very much.

Operator: Your next question comes from Rick Patel of Needham & Company. Your line is open.

Rick Patel

Analyst, Needham & Co.



Thank you. Good morning, everyone. I also have a question on some of these lingering credit issues. So, credit participation fell 720 basis points from last year and it sounds like 400 basis points of this was related to the disruptions in processes.

So once some of these challenges are resolved, do you expect to recapture that 400 basis points all else equal or do you think it will reset at a lower level? And basically, I'm a little unsure if ADS has tightened their lending standards. And if they did, to what extent that would remain a headwind going...

Michele Santana

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Chief Financial Officer, Signet Jewelers Ltd.

Yeah. So why don't I take that? In terms of – keep in mind that with ADS, whatever applications they don't approve, that flows through over to Genesis which currently Signet continues to perform the underwriting on that.

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So when you look in terms of Q3 the 720 basis points and if 300 bps was kind of the pre-trend prior to conversion, we definitely, with the disruption we saw, we saw a follow up in credit applications as well as a fall off in the actual approval rate, and that was really hindered by the downtime with the systems, call center times, frustration with the customers and store associates.

As we think about going forward and what we continue to see in the first three weeks of November is that the application volume is running similar to the pre-trend. And each week we continue to see those approval rates getting better to the point that we're largely in line. However, what we are seeing is a mix impact between in-store and eCommerce; more applications on the eCommerce side, and that has a disproportionate impact in terms of approval rate.

So I think, as we continue to work through the process change management that Gina talked about, we definitely should be able to get back to where we were, [ph] sans (50:08) the 7% of the portfolio that we talked about that will gradually start to decline the underwriting in that group.

Rick Patel

Analyst, Needham & Co.

Got it. And so, the third quarter impact was 60 basis points [indiscernible] (50:21) based on your guidance revision [indiscernible] (50:25) basis points. So is that because we're talking about a full quarter of this being a headwind? Are there other things coming into play that would create a bigger impact on [indiscernible] (50:34)

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

Yeah. What I would say, it's a full quarter – full fourth quarter and it really is worst-case scenario.

Rick Patel

Analyst, Needham & Co.

Got it. If I could squeeze in one more. Any initial reads on Interwoven [indiscernible] (50:48) whether that's able to capture the millennial customers that you're going for? Any initial thoughts on [ph] success by (50:55) banner would be great. Thank you.

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

Yeah. We're really excited about Interwoven. It's largely our first-ever initiative targeted to millennial consumers and it represents a good consumer insight which is that millennial consumers don't necessarily follow the same traditional relationship journey as their parents. Often they're weaving their lives together in different ways long before marriage. So they might move in together, even have kids together before they're buying an engagement ring.

So for the first time, what Interwoven offers them is an opportunity to celebrate that journey together, with a new item that represents how their lives have come together. And I love the sell line actually on it, wherever we go, we go together. What's also very exciting about this initiative is how we've surrounded it with millennial-targeted marketing. So it's our first-ever social media influencer campaign. I mentioned we have about a 100 influencers lined up, who will create over a 100 million impressions. These are largely couple influencers.

We've done a very interesting ad campaign for Interwoven that features a couple deciding to go on a trip together and doesn't matter where they go, they're going together and will be replicating the idea of that with sweepstakes

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offering to send couples on a trip. And what's featured in all of our marketing to date is the necklace, which is really the most important part of that item launch that we've rolled out, and the sales on that are encouraging.

So, we're excited overall about the opportunities to speak to a new target audience through new mediums in a different way and continue to learn and grow in that area of our business.

Operator: Your next question comes from Omar Saad of Evercore ISI. Your line is open.

Westcott Rochette

Analyst, Evercore Group LLC

Thank you. This is Westcott on for Omar. I have a question about the overall competitive environment. Just – I know earlier in the year there was a lot of [ph] independent liquidation that seem like that (53:12) settled out, department stores are getting a little bit more aggressive. And I know you were looking to change your promotional cadence in the back half of the year to [indiscernible] (53:28) different customers. Can you talk about where you think the environment is today and how your strategy is looking forward to [indiscernible] (53:36)

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

Sure. So I'll start and Michele, you can fill in any other detail. So first on the promotional environment. As I said, we expect a strong promotional environment, particularly in mall stores and department stores to continue. We're expecting aggressive promotions not only for Black Friday, but also through the holiday season.

We are also very pleased about the offerings that we've put in place and believe they are well tested with our customers and transparent, and really create I think a high-value shopping experience along with our high-quality merchandise and a great service that we offer customers in store. So, we are very open-eyed about what we think the promotional environment will be and believe we've constructed a good plan in that context.

Michele Santana

Chief Financial Officer, Signet Jewelers Ltd.

Yeah. I mean, I would just add for sure. Our overall goal is to grow share and do that profitably and lead the midmarket with strong bridal position and also strengthening our fashion assortment. And I think the comments that Gina had mentioned earlier show that we really have planned at the roots in all of those areas. So when we think about the strategy [ph] and going forward, I just offer that prospective as (54:57) well.

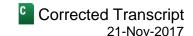
Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

Just one other thing speaking about Independence, an area where Independence has been particularly strong in the past is on solitaire diamond rings. Our loose stone volume at Jared is higher than it's been. We've put more, larger carat weights and high-quality diamonds into Kay and Zale. Solitaires are doing extremely well for us. So again, very open-eyed on the competitive environment and finding opportunities to grow our business and achieve positive market share in those bridal as well as fashion.

I don't want to miss the point I made earlier. Our fashion assortment is very strong this year in the \$200 to \$700 price point, which is the key price point we missed last year. And in total, in fashion, we have 50% more items in the right price point range than we did a year ago. So, good analysis by the team and we're feeling like we're well positioned for holiday.

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Operator: Your next question comes from Paul Lejuez of Citi. Your line is open.

Paul Lejuez

Analyst, Citigroup Global Markets, Inc.

Hey. Thanks, guys. Can you tell us specifically what was the performance of bridal on a year-over-year basis, just the percent change in 3Q versus non-bridal? And also what's the mix of bridal in 3Q versus 4Q?

And then just second, as you focus more on eCom and digital, even excluding R2Net, if you think about the core business, how are you thinking about the impact to EBIT margin as more business shifts to online? Thanks.

Michele Santana

Chief Financial Officer, Signet Jewelers Ltd.

Yeah. So let me start with bridal and then we can talk about the R2Net business model. I don't actually readily have the bridal stats in terms of percentage this quarter versus last quarter or Q4. But what we do know and as I mentioned on the call, we did see decline line in bridal. Now, that was in large part – we had a major bridal promotion in October and that overlapped, at the same time we saw the credit disruption as we are going through conversion.

And when you think about our bridal sales, 75% of bridal sales are usually done using our form of credit. So that really disproportionately impacted what we saw in the bridal during the quarter. That promotion actually was off to a very strong start before the credit transition issues hit.

And then in terms of your question on the R2Net model. So, what [indiscernible] (57:37)

Paul Lejuez

Analyst, Citigroup Global Markets, Inc.

[indiscernible] (57:38) R2Net, actually more of the core business.

Michele Santana

Chief Financial Officer, Signet Jewelers Ltd.

I'm sorry, what?

Operator: More of the core business. [indiscernible] (57:44)

Michele Santana

Chief Financial Officer, Signet Jewelers Ltd.

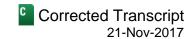
Yeah. So as we think about the shift to online, more sales being done online, to some extent that benefits us in terms of our margin rate because we don't care even though we have shipping cost, et cetera, associated with the online orders. You don't have the heavy burden of the full store costs associated with that. So that is actually a benefit to us.

Paul Lejuez

Analyst, Citigroup Global Markets, Inc.

Okay. Thanks, guys. Good luck.

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Michele Santana

Chief Financial Officer, Signet Jewelers Ltd.

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Thanks.

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

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Thank you.

Operator: Your next question comes from Kara Szafraniec of Northcoast Research. Your line is open.

Kara Szafraniec

Analyst, Northcoast Research Partners LLC



Hi. Good morning, everyone. Just two quick questions. First, understanding there was a weather impact in the third quarter due to hurricane, just wondering if you could touch on how some of those hurricane-impacted regions have rebounded post hurricane. And if you're foreseeing any negative impact into the fourth quarter due to these weather events?

Second, hoping maybe you could touch quickly on the performance of mall versus non-mall stores in the quarter? Thanks.

Virginia C. Drosos

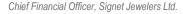
Chief Executive Officer & Director, Signet Jewelers Ltd.



Sure. So I'll take weather and then, Michele, you can talk about mall. So we have a very strong footprint actually in both Florida and Texas. We saw, frankly, more of an impact on our Sterling business than we did on our Zales business from the weather-related issue, and we are seeing consistent improvement of those stores. They didn't fully improve to pre-weather levels prior to the end of the quarter. So, are we still seeing some impacts from that? Yes, albeit small. And so, we haven't really called that out as a big fourth quarter impact, but small.

But the teams are working very hard to regain that and we're hoping that, consistent with what we've seen in the past that as customers begin to get their insurance check back in and be able to put their lives back together and are looking to celebrate and express love this holiday season that we'll be able to see some positive impact in those markets from increased buying power on consumers.

Michele Santana





Yeah. And in terms of your question on the performance between mall and off-mall, if we look at our off-mall excluding the outlets, they had performed substantially better than what we saw in terms of the mall, I'd say, in the tune of about 600 basis points better.

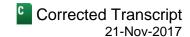
Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

All right. Well, thank you so much, everyone. That's all the time we have for questions today. We appreciate you all joining the call and we look forward to updating you in January. Happy holidays.

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

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