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Signet Jewelers Ltd. (SIG)

Q1 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is James, and I will be your conference operator today. At this time, I'd like to welcome everyone to the Signet Jewelers Fiscal 2020 First Quarter Earnings Call. [Operator Instructions] Thank you.

I'd now like to turn the call over to the SVP of Investor Relations, Randi Abada. Please go ahead.

Randi Abada
Senior Vice President-Corporate Finance Strategy & Investor Relations, Signet Jewelers Ltd.

Thank you, James. Good morning and welcome to our first quarter earnings conference call. On the call today are Signet's CEO Gina Drosos; and CFO, Joan Hilson.

During today's presentation we will 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 quarterly reports on Form 10-Q. Except as required by law, we undertake no obligation to revise or publicly update forward-looking statements in light of new information or future events.

During the call, we will discuss certain non-GAAP financial measures. For a discussion of the non-GAAP financial measures, as well as reconciliations of the non-GAAP financial measures to the most directly comparable GAAP measures, investors should review the news release we posted on our website.

I'll now turn the call over to Gina.

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Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

Thank you, Randi. Good morning, everyone, and thank you for joining today's call. To begin, I would like to thank all of our team members, who provide outstanding customer service every day and who are doing important work delivering our Path to Brilliance transformation initiatives to our customers. In my remarks today, I'll start by discussing first quarter results, and then move on to progress of our transformation. I'll wrap up with some brief comments on our financial guidance.

Our first quarter results reflect progress against the year two Path to Brilliance priorities we announced on our last call. We continue to improve our operation, while navigating through a very competitive U.S. retail landscape with soft traffic trends and a difficult UK macro environment.

While it is early in the year, we continue to grow eCommerce sales, are beginning to see some momentum on our fashion product performance, and our commitment to cost discipline is positively impacting operating profit. Additionally, we've made solid progress on inventory management and generated strong free cash flow in the quarter. Here are some highlights of our first quarter performance.

We delivered same-store sales growth at the lower-end of our guidance range, with total company same-store sales down 1.3%. eCommerce was up 12.6% in our North America banners excluding James Allen, and up 5.3% on a consolidated basis. James Allen experienced continuing pressure from the implementation of sales tax. In brick and mortar, we continue to see softness in transactions and high levels of competition in key promotional periods.

We continue to execute on our new product strategy to build bigger, iconic, and inspirational flagship brands; offer a highly competitive assortment for value-oriented shoppers, especially during holiday periods; and deliver relevant on-trend products. In the first quarter, we continued to see benefits from the ongoing refreshment of our assortment, with the percentage of sales from new merchandise increasing year-over-year in North America.

In bridal, our flagship brands Disney, Vera Wang, Neil Lane, and Leo were up high single-digits, offset by some softness in non-branded bridal and continuing declines in legacy collections. Fashion sales were up across all our North America banners, with on-trend gold and our in-house designed Love + Be Loved collection, positively contributing to growth in fashion.

Turning to profits and cash flow. Our first quarter non-GAAP operating profit performance was similar to last year, reflecting broad scale cost efficiencies, some benefit from the timing of SG&A expenses, and an increase in advertising. We stabilized North America merchandise margin in the quarter, despite a highly competitive environment in key promotional periods and implementing a strategic effort to lower inventory.

As I discussed on the last call, we are focused on generating higher free cash flow in fiscal 2020. In the first quarter, free cash flow was $80.8 million versus $1.8 million in the prior year first quarter, largely driven by improvements in working capital, together with disciplined capital spending. We are implementing enhanced inventory planning under the leadership of our new CFO, Joan Hilson, and our new Chief Merchant, Toni Zehrer, and we continue to expect inventory to be lower year-over-year at the end of fiscal 2020.

Now I will discuss our Path to Brilliance transformation plans. We are underway on our fiscal 2020 growth initiatives under our strategic pillars of Customer First, OmniChannel, and Culture of Agility and Efficiency. These initiatives build on the foundational capabilities developed in year one of Path to Brilliance, with investments in

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systems, capabilities, product assortment, and store experience funded by driving out costs customers don't see or care about.

Beginning with Customer First. In product, we continue to build our iconic and inspirational flagship brands. Our Disney partnership continues to expand, with the inaugural film collaboration between Zales and Disney, bringing the magic of the Aladdin Cave of Wonders to a real-life jewelry collection. Our exclusive designs feature beautiful Jasmine-inspired design details, and embody the style and trends that the Zales customer expects. The Aladdin launch is performing well, and we believe it has elevated customer interest across the entire Enchanted Disney product portfolio.

In bridal, we continue to refresh the assortment with new designs for our flagship brands, Vera Wang and Neil Lane; additional new core bridal designs; as well as enhancing customer choice through the innovative virtual assortment now available in all Jared stores.

We are seeing positive results from the refresh of our fashion assortment. Our on-trend new core assortment in gold continues to be a growth driver and our Love + Be Loved fashion collection is performing well.

Love + Be Loved is Toni's first in-house design collection that was launched in a limited number of stores in the fourth quarter holiday. We expanded the collection more broadly across the Kay banner during the first quarter, added color and personalization options, and ran our first Love + Be Loved advertising campaign at Mother's Day. We are seeing early indications that Love + Be Loved has potential to grow into a meaningful proprietary fashion brand, with several designs selling out after the marketing campaign began. On a smaller scale, we are introducing more men's options across our product lines, including gold, Love + Be Loved, Disney, and Vera Wang.

We've implemented full volumetric testing of new product lines, which is helping to shorten the product development cycle by giving us a faster read on the sales potential of new ideas. Several of the proprietary collections currently in test at select stores are showing encouraging early results, as we build a competitive, differentiated product assortment for holiday and into fiscal 2021.

While we are encouraged by the positive results of our new products in the first quarter, as I mentioned during our last call, fully evolving our assortment is a multi-year journey, given the long jewelry purchase cycle. Customers are responding to our higher levels of newness, but we do have some headwinds to sales in fiscal 2020 from legacy products that are nearing the end of their lifecycle.

Moving on to marketing, we've made strategic changes to our marketing model to drive greater efficiency and effectiveness. The timing of advertising spend has been rebalanced to a more always-on model to support bridal throughout the year and grow our share of gifting occasions, such as birthdays and anniversaries.

We expect to improve return on investment by moving to a higher mix of digital advertising, as well as more efficient targeting of spend. We invested in a customer data platform last year, which is providing insights that our new data-savvy media agency will utilize as they work with our team to build more efficient and effective buying plans.

Additionally, new creative agencies for each of our core banners are helping modernize our content and messaging, while making progress in differentiating the brand equities. Recent new campaigns include Enchanted Disney Aladdin at Zales, the first Love + Be Loved campaign at Kay, and an innovative integrated bridal and

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fashion campaign at Jared. We will launch summer bridal campaigns with new creative content for Zales and Kay, and we have strong plans for new targeted, data-driven, integrated campaigns for holiday.

Our Voice of the Customer (sic) [Voice of Customer] (00:18:49) Net Promoter system, which was launched in the second quarter of fiscal 2019, continues to provide actionable data and insights. During the first quarter of fiscal 2020, each North America banner reached its highest Net Promoter Score since the inception of the program.

Most importantly, we are seeing high levels of team member engagement with the program. Store managers receive real-time feedback about performance in their store, which is a key enabler of elevating our customer-centric experience.

Turning to OmniChannel, in fiscal 2020, we are substantially increasing our investment in platform and mobile technology, and continuing to build best-in-class customization capabilities. The Kay and Jared transition to hybris, a significantly more contemporary, dynamic platform already in use on Zales and Piercing Pagoda, is currently on track and expected to launch in Q3, ahead of holiday. The hybris platform enables an enhanced customer experience, with faster load speeds, higher quality images, and improved curated search.

Our second priority for fiscal 2020 is our investments in mobile experience, which include faster load speeds, search and browse functionality, and personalized curated product pages. These mobile initiatives are expected to go live throughout this year at Zales, with Kay and Jared following post the hybris conversion.

We are also continuing to build best-in-class customization capability, including the recent introduction of the Vera Wang Love tool at zales.com and enhancements to make our current Design Your Own programs more mobile-friendly. In the first quarter, we saw the number of orders generated by our online bridal Design Your Own tools nearly double. And we believe the customization enhancements we are making this year will be positive contributors to eCommerce growth. We believe that these changes will set us up to drive higher traffic to our sites and create a much more compelling online experience across all of our North America banners.

Moving on to Culture of Agility and Efficiency. We continue to focus on operational excellence, agility, and creating a continuous culture of cost optimization, which we saw positively impact our first quarter results. We are raising our fiscal 2020 expected net cost savings to $70 million to $80 million versus $60 million to $70 million previously, with savings primarily driven by indirect procurement, workforce optimization, and lower corporate costs.

Our direct procurement negotiations with our vendors to lower our costs and optimize working capital began last year, and we are in the process of finalizing agreements, which will impact our fourth quarter holiday purchases and also benefit fiscal 2021. We are also testing field labor optimization initiatives to better service our customers by deploying our team members more effectively during peak periods. Our three-year Path to Brilliance net cost savings goal remains $200 million to $225 million inclusive of the $85 million in net savings achieved in fiscal 2019.

We continue to expect our category to be an OmniChannel category, with an optimized smaller portfolio of stores representing a competitive advantage. We plan to close approximately 150 stores in fiscal 2020 and expect overall store count at the end of the transformation plan in fiscal 2021 to be lower than fiscal 2020 year-end levels. By the end of our three-year transformation plan, we believe we will have materially reduced our exposure to lower grade malls and simplified our portfolio by exiting most of our regional banners, while developing new concepts to drive growth.

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Before I turn the call over to Joan, I will briefly discuss our fiscal 2020 financial guidance. We are revising our same-store sales guidance range to down 2.5% to down 1.5%, reflecting first quarter results at the low-end of our sales expectations, lower traffic expectations, and sales trends we saw in May. We are revising our non-GAAP operating profit guidance to $260 million to $280 million, which embeds our revised same-store sales expectations and higher cost savings.

As I mentioned earlier in my remarks, we made strong progress on lowering our inventory levels in the first quarter, and expect to generate higher adjusted free cash flow in fiscal 2020 versus fiscal 2019.

Let me comment briefly on the subject of tariffs. The three tranches of tariffs that were enacted in 2018 have no meaningful impact on our business and are currently factored into our 2019 guidance. There's potential for an additional fourth tranche of tariffs, which could impact us. But because there is still uncertainty around it, we don't believe this issue warrants a change to our financial guidance at this point.

Our exposure to Chinese goods is approximately 30% of our merchandise spend. We are developing contingency plans to activate the flexibility of our multinational vendor base to minimize the impact on our business and on our customers. While we do have flexibility in our supply chain, there is also a potential pricing impact to our U.S. customers if these tariffs are enacted. We are hopeful for a speedy resolution, and we'll continue to update you when there's more clarity on this matter.

In closing, we made progress in the first quarter stabilizing our North America merchandise margins, delivering cost savings, and more efficiently managing inventory with a focus on cash generation. We remain confident that Path to Brilliance is the right strategy to improve the trajectory of our same-store sales and drive higher profitability over the long term. The team is highly focused on executing our transformation initiatives and we look forward to updating you on our progress as we move through the year.

And now, I'll turn the call over to Joan.

Joan Holstein Hilson

Chief Financial Officer, Signet Jewelers Ltd.

Thanks, Gina, and good morning, everyone. I'm pleased to be here today on my first earnings call as Signet's CFO, and I'm excited to join the Signet leadership team. I look forward to meeting with many of you in the months to come. In my remarks, I'll cover the highlights of our first quarter financial results, then discuss our guidance, and conclude by sharing my initial priorities.

Beginning with our first quarter results, in the first quarter, same-store sales declined 1.3%. North America showed strength in Piercing Pagoda and eCommerce, offset by softness in bricks and mortar in our larger banners. International results continue to reflect the challenging operating environment in the UK.

Revenue declined 3.3%, reflecting lower same-store sales, the impact of net store closures, and the impact of foreign exchange. Gross margin expanded 220 basis points in the quarter and was impacted by a number of structural items.

First, the outsourcing of our non-prime receivable portfolio resulted in a benefit of 320 basis points as we lapped two months of bad debt expense in the prior year quarter. Second, there was an unfavorable impact of 65 basis points related to higher year-over-year sales of diamonds to third parties from our diamond polishing operations in Botswana.

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The sale of these diamonds that cannot be used in our own banners with the objective of recovering our costs, generates cash flow, but has an unfavorable mix impact on our gross margin rate. We expect higher year-over-year sales of diamonds from our Botswana facility in the remainder of fiscal 2020 and have incorporated the margin rate impact in our guidance.

And finally, as expected, there was an unfavorable impact of 25 basis points related to the timing of revenue recognition on service plans. Importantly, we stabilized merchandise margin in our North America banners this quarter.

SG&A was down on a dollar basis year-over-year, with higher credit costs due to outsourcing and incremental investments in advertising fully offset by lower staff costs on a smaller store base, cost savings, and a timing shift in expenses of $5 million. SG&A was higher as a percentage of sales, reflecting deleverage from lower sales.

Non-GAAP operating profit was in line with prior year, with the benefits of credit outsourcing largely offset by higher advertising investment as we implement a more always-on strategy. We continue to expect advertising spend to be down slightly on a full year basis.

Non-GAAP EPS of $0.08 reflected flat operating profit and a lower share count, offset by a more normalized higher tax rate versus prior year. We continue to expect a higher tax rate to impact our EPS during the remainder of fiscal 2020.

Moving to balance sheet and cash flow. We made progress in managing inventories, with first quarter ending inventory up slightly versus fourth quarter level, while continuing to bring in new assortment. Free cash flow was up $79 million versus a year ago, largely driven by inventory discipline.

During the first quarter, we adopted the new standard for lease accounting. Our prior financial statements remain in accordance with the old accounting standards. The impact of the adoption was recognition of operating lease assets of $1.8 billion and operating lease liabilities of $1.9 billion. The new standard does not have a material impacts to our income statement or statement of cash flows.

Now I'll move on to our guidance for the second quarter and full year 2020. We expect second quarter same-store sales to be down 2.5% to down 3.5%, inclusive of an estimated 35 basis points unfavorable impact of the Jared promotion that moved into the first quarter this year from the second quarter last year, and an estimated 45 basis points unfavorable impact from a timing change to revenue recognition on service plans.

The guidance includes sales trends we saw in May, an expectation of continuing traffic challenges, difficult UK macros, and sales tax headwinds at James Allen. As a reminder, we have a tougher prior year sales comparison in the second quarter versus the first quarter.

Operating profit is expected to be $35 million to $40 million in the second quarter. This outlook reflects an expected unfavorable $7 million to $9 million impact from credit outsourcing, higher advertising, and lower sales, partially offset by cost savings.

We lapped the non-prime transaction late in the second quarter. As a result, we will have higher credit fees in SG&A on a year-over-year basis. Non-GAAP EPS is expected to be in a range of $0.23 to $0.30, reflecting a higher year-over-year tax rate of 16.5% to 17.5%.

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Moving on to full year fiscal 2020 guidance. As Gina mentioned earlier, we are revising our full year same-store sales guidance to down 2.5% to down 1.5%. Please note that the fourth quarter has an easier prior year comparison versus the earlier quarters.

We are revising our operating profit guidance to $260 million to $280 million, reflecting our revised same-store sales outlook and higher cost savings. Our operating profit guidance incorporates a flat overall year-over-year impact of credit outsourcing, inclusive of our expectations of an increase in the non-prime MDR in the second half fiscal of 2020. Non-GAAP EPS is expected to be $2.88 to $3.17 and, as previously communicated, reflects a higher year-over-year tax rate and no share repurchases.

Now I would like to make some comments on our outlook for inventory, free cash flow, and leverage. We made progress on more efficient inventory management in the first quarter, but have more work to do to lower our inventory levels as we move through the year. We do expect inventory to be down versus prior year by the end of fiscal 2020.

In fiscal 2020, we believe improving our inventory position and focusing on disciplined working capital management will result in an increase in adjusted free cash flow versus prior year, exclusive of the prior year credit transaction proceeds.

Now with respect to leverage, we ended fiscal 2019 with an adjusted debt-to-EBITDA ratio of 4.3 times. At the end of our transformation plan in fiscal 2021, we expect our leverage ratio to be approximately 4 times. This leverage ratio is calculated under our historical methodology, which includes lease obligations of debt under a 5 times rent methodology. For full details of our leverage ratio calculation methodology, please see our 2019 Form 10-Q.

Our fiscal 2021 leverage outlook is based on our guidance range for fiscal 2020, our projections for EBITDAR and free cash flow, and the amount of cash we want to maintain on our balance sheet.

To wrap up my comments, I would like to share that after my first eight weeks, I believe there are real opportunities to drive value creation in a number of important areas. My early focus will be on driving cost savings to provide fuel for reinvestment in growth and enabling higher profitability, unlocking working capital and opportunities primarily through more efficient inventory management, and implementing robust forecasting and financial analytics.

And now, I'll turn the call over to the operator to begin the Q&A session.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Rick Patel from Needham & Co. Go ahead, please. Your line is open.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

Good morning, and welcome, Joan, great to have you on the call.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

Thank you.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

A question on your digital performance. So, you're seeing lower comps for James Allen, but higher comps for eCommerce and legacy banners. Can you just help us understand the disparity in your expectations for the rest of the year? And as we think about your product strategy at James Allen, would you consider selling branded merchandise there to reinvigorate sales?

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

A

Thanks for the question. So, we continue to expect growth in our overall eCommerce business for the year. As I talked in my remarks, our OmniChannel strategy for the last over a year and a half has really focused on making improvements in the customer experience, both by reinventing our web platforms and by adding new functions and features especially to the mobile experience, so things like our configurators, which we've seen the sales virtually double in those in just a year, will continue to be emphasis for that program.

James Allen continues to add more states collecting sales tax. In the first quarter, California came on board, and so we expect continuing headwinds on James Allen for the rest of this year certainly as we weather all those changes in sales tax. We do sell branded merchandise on James Allen. We have a number of designer bridal jewelry brands that we carry, and they do very well. We have a very discerning customer who comes to James Allen, nice transaction value, ticket value there. And so we make sure that we're offering a broad range of not only high-quality diamonds, but also beautiful semi-mounts from different designers.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

Can you also touch on the outlook for gross margins? After the impact of credit outsourcing is completely in the base, how should we think about gross margin progression as we think about the various puts and takes? And big picture, where do you see the biggest opportunity to drive gross margin improvement for the underlying jewelry business?

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

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So, the big picture response to that is that, as we drive through our inventory management program and effectively manage through our clearance, which is truly in the guidance that we've given for the year, we believe that as we continue to implement those programs, that we'll be able to positively impact gross margin.

In the long-term, the cost initiatives that Gina mentioned in her prepared remarks on procurement is also very important to improving the merchandise margin. And as we look at the stabilization of merchandise margin and turn to growing our services business, that will also help us to have a positive impact on our merchandise margin.

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

The only thing I would add on that is, as you know, we changed our merchandise strategy last year. The first pillar of that is building differentiated proprietary brands, Love + Be Loved being a good example of that, and so we see that as an opportunity also to build margin over time.

Rick B. Patel
Analyst, Needham & Co. LLC
Q

Thank you very much.

Operator: Your next question comes from the line of Simeon Siegel from Nomura Instinet. Go ahead, please. Your line is open.

Simeon Avram Siegel
Analyst, Nomura Instinet LLC
Q

Thanks. Good morning, guys, and welcome, Joan. First of all, any color you can give on the current comp trends, just given the comments about the softening retail traffic? And then, Gina or Joan, just recognizing the significance that Q4 plays into your business model, can you help with what you're embedding for 4Q EPS within the full year guide? And then just lastly, Joan, just wanted to clarify, did you say you expect the MDR to increase in the back half? Thank you.

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

Hi, Simeon. So, I'll start out, and then turn it over to Joan for, I think, your last two questions. On the first one, we have seen some softening trends in May. That is embedded in our guidance. Consistent with many other retailers, we're seeing some softer traffic trends. We do continue to see a higher percentage of sales from our new merchandise. And as we work through some of our legacy collections and get a higher percentage of new into our stores, we think that we're strengthening our closure opportunities certainly for the people who are coming in.

Also have a number of training initiatives going on with our field team. They continue to be one of our biggest competitive advantages. So that, as traffic trends go down, we're still creating a differentiated and truly best-in-class customer experience in the store.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.
A

Simeon, to address the credit impact, as I mentioned, in the Q2 quarter – Q2 is the last quarter we lap the completion of the outsourcing of the non-prime portfolio. So we have additional SG&A costs related to sales to our non-prime customers, with no offset for elimination of bad debt expense, which we had in Q1. So that's why it's

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higher in the second quarter. And then, I did mention in our comments that we have incorporated an expectation of an MDR change for the second half of the year into our guidance. And as a reminder, we have updated our credit guidance for full year fiscal 2020 to flat from flat to slightly down, given the performance that we saw in the first quarter.

Simeon Avram Siegel
Analyst, Nomura Instinet LLC

Q

Okay, great. Thanks. And then, anything in terms of the Q4 EPS that's embedded in the guidance?

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

Well, what I can tell you is that, when you look at our guidance in – the guidance range for the year, on the low side, the first half is down 2.4% and the back half on the low end is down 2.7%. On the high-end, the front half of the year is down 1.9% and in the back half of the year the high-end would be down 1.2%.

Simeon Avram Siegel
Analyst, Nomura Instinet LLC

Q

Okay. All right, thanks a lot, guys. Best of luck for the rest the year.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

Thank you.

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

A

Thank you, Simeon.

Operator: [Operator Instructions] Your next question comes from the line of Ike Boruchow from Wells Fargo. Go ahead please. Your line is open.

Ike Boruchow
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning, everyone. Welcome, Joan. I guess just to follow-up on Simeon's questions about May, Gina, I was wondering whether you could help us with where the softness is. Is it across the entire portfolio or is it more specific to one of the banners, understanding that Jared has more headwinds than some of the others with the legacy business and Pandora business? Just kind of curiosity could help us understand where that weakness is coming from.

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

A

Yeah. What we're seeing is largely a decline in the retail mall traffic. We have a number of initiatives that we've put in place. As you saw from the first quarter numbers, the softness that we experienced was largely in James Allen and in Zales. James Allen we expect to continue, given the sales tax issues. Zales saw some softness on unbranded bridal. And so, we've put some new programs in place to really shore that up from a product standpoint, and have a new advertising campaign as part of our always-on media model launching this summer.

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So, I think we've got some good initiatives coming. But like all retailers, we saw a softening in the traffic trends in May.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.
A

The only thing I would add to that is that, as a reminder we mentioned that there was a promo shift from Jared into the first quarter from the second quarter of last year.

Ike Boruchow
Analyst, Wells Fargo Securities LLC
Q

Got it. And then just two quick ones for you, Joan. On the SG&A, I believe you said there was some kind of timing shift that has helped you in Q1. I assume it's going to hurt Q2. I was wondering if you could quantify that for us.

And then, I think you said free cash flow should be up year-over-year ex the credit sales. So, just to make sure my numbers are right, does that mean free cash flow should be above, I think it was like $120 million in free cash last year?

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.
A

Yeah. So, yes, that's accurate for the free cash flow for the year. And then, the SG&A was favorable by $5 million in the first quarter and we expect that to impact the balance of the year, not fully in the second quarter.

Ike Boruchow
Analyst, Wells Fargo Securities LLC
Q

Got it. Thank you.

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

Thank you.

Operator: Your next question comes from the line of Paul Lejuez from Citigroup. Go ahead please. Your line is open.

Tracy Kogan
Analyst, Citigroup Global Markets, Inc.
Q

Thanks. This is Tracy Kogan filling in for Paul. I had two questions. The first is a clarification. You guys mentioned, I think, 30% of your goods coming from China, and I just wanted to find out if that was just on jewelry or does that include non-merchandise items, like boxes and packaging.

And then my second question was about the credit penetration, but within the credit penetration whether you saw an increased penetration of the leasing sales. Thanks.

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

So I'll take the first one. The 30% referred to merchandise, there is additional, but quite small, impact on boxes, packaging, things like that, in the quarter. And just like we are on merchandise, we have a multinational supply

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chain. And so, we are looking at opportunities to work that with our vendors and reduce any impact to the company or to customers through pricing, and I'll let Joan answer the second.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.
A

Well, we don't give guidance or the details around the leasing program itself. Our credit penetration – the plan participation rate was 50% versus 51.1% in the prior year first quarter. And just as a reminder, on the Q4 earnings call, the guidance was slight decline in payment participation rate for the year.

Tracy Kogan
Analyst, Citigroup Global Markets, Inc.
Q

Any color you can give on the leasing, whether customers are – maybe you can't quantify, but just whether anecdotally customers are gravitating toward that choice?

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.
A

Yes, we feel that leasing – based on what we're seeing, the leasing option is a positive for us with the non-prime customer. Those that would have normally participated, with that offering are migrating nicely to the leasing program. So we see that's a positive and a good offering and important to our customer.

Tracy Kogan
Analyst, Citigroup Global Markets, Inc.
Q

Thanks. Good luck, guys.

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

Thank you.

Operator: Your next question comes from the line of Dana Telsey from Telsey Advisory Group. Go ahead, please. Your line is open.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC
Q

Good morning. I noticed on the commentary that – and welcome, Joan – that now there's around 150 store closures; before it was more than 150. At the end of the day, where do you want to be for each concept in terms of stores and anything different in the UK from here in the U.S.? And is there more rent negotiation opportunity for you? Thank you.

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

Thank you. So, we're anticipating closing at or around 150 stores this year. As you know, last year we over-delivered the guidance that we had given on store closures. So, I think we continue to take a very disciplined and analytical approach to store closures, looking at trade areas, looking at sales transference, really making sure we are creating a smaller, but more optimized store base, since we see that as a competitive advantage.

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What we have guided is that by the end of the transformation program, the three years, we expect the store count to be lower than it was at the beginning. So I anticipate that this program of discipline will continue. At the same time, we work on growth concepts as well to be able to successfully make sure we're covering all of our banners and our customer base. Piercing Pagoda is an example of a banner that has consistently been growing very well. And so, we have a discipline around looking at new concepts, on the other hand.

In terms of UK versus U.S., we have store closures going on in both markets and the process is similar. And in terms of rent negotiations, absolutely, we continue to leverage our scale and partnership with larger landlords to work on optimizing our space, but also negotiating rent reductions.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Thank you.

Operator: Your next question is from the line of Omar Saad from Evercore ISI. Go ahead, please. Your line is open.

Westcott Rochette
Analyst, Evercore Group LLC

Q

Thank you very much. This is Westcott on for Omar. Can you give an update on the bridal category, kind of where bridal penetration is as part of your sales now versus a couple of years ago and what do you think is going on in that category?

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

A

Sure. So, what I said in my prepared remarks is that our bridal category was down in the first quarter. We saw strong growth from our iconic flagship brands across the board. So, Neil Lane, Vera Wang, Disney, Leo, all of those were up high single digits. And so, the newness that we're bringing, the emphasis on those proprietary brands has been important and is showing good dividends for us.

Non-branded bridal is where we saw a bit of softness in the quarter, especially in Zales and in Kay. And then, James Allen, as you know, is really 100% almost a bridal business. I mean, it's really heavily skewed to bridal. In terms of penetration number as percentage of sales and things, that's not something that we have talked about.

Westcott Rochette
Analyst, Evercore Group LLC

Q

Okay. Could you say directionally versus a couple years ago whether the penetration on bridal is up versus fashion or...

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

A

Well, I think bridal is incredibly important to us, and so we're working to grow both. In the first quarter, we saw some growth in the fashion part of the business, which was helpful and represents our strategy to build gifting, especially at non-holiday periods, and to attract female self-purchasers into our business.

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Westcott Rochette
Analyst, Evercore Group LLC

Q

Okay. Thank you. And just one other question. As far as the employees being up-to-speed, incentivized on how to use the credit and implement the credit effectively, where do you think the employee education and incentive structure is to employ all the credit options available to the customer?

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

A

Great question. So I think now we have gotten to a mix of financial offerings for our customers that represents a competitive advantage with the prime lending, the subprime lending, and also the leasing program that we have in place. After we experienced some operational issues surrounding the conversion to that a little over a year ago, we put more than 80 technology fixes in place and significant training for our in-store personnel, and that's something that we haven't stopped. We in the first quarter had a four-hour training for all of our sales associates to work on how they present our different financial alternatives to our customers. So, I see that as an ongoing opportunity for us to build that competitive advantage.

Westcott Rochette
Analyst, Evercore Group LLC

Q

Thanks very much. Good luck.

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

A

Thank you.

Operator: And with that, there are no further questions. I'd like to thank everyone for joining us today. This concludes today's conference call and you may now disconnect.

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