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Signet Jewelers Ltd. (SIG)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Jessa, and I'll be your conference operator today. At this time I would like to welcome everyone to the Signet Jewelers Fiscal 2019 Fourth Quarter Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Ms. Randi Abada, Senior Vice President of Investor Relations, you may begin your conference.

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

Thank you. Good morning and welcome to our fourth quarter earnings conference call. On the call today are Signet's CEO, Gina Drosos; and CFO, Michele Santana. 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 press release we posted on our website.

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I'll now turn the call over to Gina.

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 for their passion in helping each and every one of our customers celebrate life and express love and for leading bravely as we accelerate Signet's transformation plan.

In my remarks today, I'll first discuss the progress of our transformation and our priorities for fiscal 2020. Then I'll wrap up my comments with our financial guidance, cash flow and capital allocation. In fiscal 2019, we launched a three-year comprehensive transformation plan Signet's Path to Brilliance to reposition the company to be the OmniChannel jewelry category leader.

The goal of our transformation plan is to drive sustained growth by delivering inspiring products and ideal online and in-store shopping experiences to our customers. Funding for the improvements we need in systems, capabilities, product and stores comes from driving out costs that customers don't see to invest in what they care about.

This transformation will be a multi-year journey that we believe will position the company to drive long-term sustainable, profitable sales growth and create value for shareholders.

Over the last few months, we have performed a detailed review of our fiscal 2019 performance and a foundational capabilities developed in year one of Path to Brilliance. Additionally, we have restructured parts of the organization and made leadership changes aimed to position us for success.

It's clear that though we believe Path to Brilliance is the right strategy, we must move faster and more aggressively to achieve our goals. The learnings from this last year have been incorporated into our forward plans to improve both execution and financial performance.

Year two of Path to Brilliance will build on the foundational capabilities developed during year one, while accelerating growth initiatives to drive customer relevance, aggressively addressing our cost structure and bolstering our balance sheet.

We have plans under each of our strategic pillars of Customer First, OmniChannel and Culture of Agility and Efficiency to change the trajectory of our same-store sales, stabilize and expand margins and improve our cash generation as we progress through our transformation.

Beginning with same-store sales, everything we do at Signet will continue to be focused on driving and inspiring full-service seamlessly connected customer experience. Our fiscal 2020 plans include improved product assortment and differentiation, upgrading our websites and mobile platforms to deliver double-digit eCommerce growth through a better customer experience and expanding our services businesses.

We have made significant progress, understanding the key customer journeys of bridal, gifting, self-purchase and repair, which allows us to tailor new product, marketing and promotional strategies based on why and how customers are engaging with us.

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In product, our strategy involves building bigger iconic and inspirational flagship brands, offering a highly competitive assortment for value-oriented shoppers during holiday periods and making Signet a leader in on-trend product. This will be a multi-year journey with fiscal 2020 expected to continue to see some headwinds from legacy brands, which we expect to begin to ease as we move through the year.

Jamie Singleton who has led our Zales and Peoples banners has recently added Kay to her responsibilities. Jamie has a strong merchandising background and track record of driving growth. And together with our new Chief Merchant, who started last spring, I am confident their expertise will help us deliver an inspirational customer-focused product assortment that is differentiated by banner.

In bridal, we intend to innovate and grow our flagship brands Neil Lane, Vera Wang Love and Disney Enchanted build on fiscal 2019 wins in fancy shapes and color and continuously upgrade our assortment with fresh designs. We have built new capabilities to enhance our innovative product development and testing to better qualify customer-inspired ideas.

Flowing from this, we plan to expand and grow our in-house designed Love + Be Loved collection, beginning at Mothers' Day, expand testing of several new collections of flagships and fashion lines to impact holiday and will launch new anniversary and gifting products later in the year to help replace Ever Us as it nears the ends of its life cycle.

This will start to result in a competitive and differentiated product assortment that is more exclusive to Signet, which will improve customer relevance. We will also build on our fiscal 2019 success in gold with a pipeline of new on-trend core assortment.

Turning to marketing. We plan to transform our marketing model in fiscal 2020 by rebalancing the timing and mix of our media investments, leveraging a more personalized journey-based approach and modernizing our content and messaging. In fact, fiscal 2020 will be the first year that Signet spends more on digital and social marketing than on television advertising.

Building on successful always-on bridal tests at Kay, we plan to grow our share of gifting occasions with a targeted focus on special occasion milestones like birthdays and anniversaries. We will also aim to significantly improve the effectiveness of our creative campaigns, building on the banner differentiation work launched in fiscal 2019.

Within the past year, we've brought on new creative agencies for every North American banner as well as a new data-savvy media buying agency. Together, we are evolving our campaigns with more sophisticated journey-specific content, and leveraging our competitive advantage in jewelry category data analytics to more efficiently target our spend.

Building a best-in-class mobile experience and driving digital innovation as we progress on our Path to Brilliance is another key component to improve our same-store sales trends. We delivered mid-teens growth in eCommerce in North America in fiscal 2019, driven by investments in Design Your Own customization tools, increasing the number of high-quality proprietary 360-degree images and personalization and curation initiatives.

In fiscal 2020, we are substantially increasing our investments in platform and mobile technology. We plan to convert Kay and Jared to the hybris platform, a significantly more contemporary dynamic platform already in use on Zales, which enables better customer experience through faster speed, higher-quality images and improved curated search.

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In addition to leveraging learnings from the Zales implementation, the Kay and Jared transition is expected to be much less complex than Zales hybris implementation, because it is only a change in technology platform. We expect the platform change to be in place by the end of Q3 ahead of holiday. Additionally, we are continuing to build best-in-class customization capability, including the launch of a new Vera Wang Love tool at Zales.com and enhancements to make our current Design Your Own programs more mobile-friendly.

Mobile experience investments will include faster load speeds, search and browse functionality, and personalized curated product pages. We believe that these changes set us up for driving higher traffic and creating a much stronger online experience.

Another important aspect of improving our long-term sales performance is services. We plan to increase competitive advantage by using our full-service jeweler capabilities to drive traffic and create higher frequency relationships with our customers. We're continuing to develop new tools and tracking technology for our repair business and expect to begin marketing our repair expertise to customers later this year.

We will also leverage our Piercing Pagoda expertise to begin testing piercing in several Kay stores in the second half of fiscal 2020. We expect services to be a meaningful revenue driver for Signet over time and a small contributor to sales growth in fiscal 2020 as we learn and scale our efforts.

Turning to margins. A key component of our Path to Brilliance plan is reducing costs customers do not see or care about to fund growth initiatives and improve our profit margins. In fiscal 2020, we expect to generate higher growth cost-savings to fund increased investment in OmniChannel and innovation, resulting in net cost savings of $60 million to $70 million. These include direct and indirect procurement savings, workforce reductions, consolidation of facilities, and lower corporate costs.

We continue to optimize real estate, working toward a portfolio of fewer better stores that deliver a fully connected OmniChannel journey that delights our customers and generate higher financial contribution. By the end of fiscal 2020, we expect we will have reduced our store base by 13% over a three-year period, materially reduced our exposure to lower-grade malls, and simplified our portfolio by exiting most of our regional banners. We expect overall store count at the end of the transformation plan to be lower than fiscal 2020 year-end levels.

As the store footprint is strategically reduced and repositioned, we believe we can increase productivity and make more focused impactful investments in compelling digitally-enabled new store designs, as well as a targeted store experience updates across the portfolio. In addition to our sales growth initiatives, cost savings and real estate efforts, we expect to drive operating margin expansion through adding more differentiated exclusive merchandise, modernizing and simplifying IT systems, and generating a greater mix of higher margin service revenue.

Moving on to cash generation. Our fiscal 2019 adjusted free cash flow was below prior-year trends, driven by lower operating income and primarily due to higher levels of inventory. In fiscal 2020, we expect to improve our cash generation and are highly focused on lowering our inventory levels, as we work through legacy product and implement a more enhanced planning process under our new leadership.

We also expect our capital expenditures to reflect lower investments in new stores as we rationalize our physical store footprint somewhat offset by continuing investment in IT to support eCommerce and systems upgrades.

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And now, I will briefly discuss our fiscal 2020 financial guidance. We expect same-store sales to be flat to down 2.5%, non-GAAP operating income of $260 million to $300 million and a lower non-GAAP EPS versus fiscal 2019, primarily due to a significantly higher tax rate in fiscal 2020.

While we expect to make bolder and faster progress on our Path to Brilliance initiatives in fiscal 2020, some headwinds remain. We face a very competitive retail landscape and uncertain macroeconomic and political environment in our U.K. market, continuing pressure from the implementation of sales tax across several additional states for our James Allen online banner and some margin pressure related to the need to clear excess inventory. However, we remain favorably positioned as the largest specialty fine jewelry retailer. We have seen some signs of improvements in our mall-based banners and we expect more transformation initiatives to take hold in fiscal 2020.

I'll now wrap up my comments with some thoughts on capital allocation. We are committed to building a more durable balance sheet to support our growth priorities for the business and continue to return cash to shareholders. In fiscal 2020, we are maintaining our quarterly dividend per share of $0.37. Our fiscal 2020 guidance does not embed any share repurchases as we intend to build cash on our balance sheet. We now expect our leverage ratio to reach approximately 3.5 times by the end of fiscal 2021.

In closing, as I look back at fiscal 2019, we made meaningful progress, improving our capabilities and laying the foundation to change the trajectory of our operational and financial performance. Our transformation remains a multi-year journey to bring new customers into our stores and keep them engaged with us, improve our profitability and invest in short- and long-term strategic initiatives. Our team is highly engaged and work is well underway to move us along the path to sustainable profitable growth and improving shareholder value.

I'll now turn the call over to Michele.

Michele Santana

Chief Financial Officer, Signet Jewelers Ltd.

Thanks, Gina; and good morning, everyone. I'll begin with some brief comments on our fourth quarter results and then move on to our fiscal 2020 guidance and our outlook for the first quarter. As we indicated in our holiday press release, fourth quarter results were impacted by lower traffic in key December holiday gifting weeks, some success in new merchandise that was offset by a faster-than-expected decline in legacy product collections in a highly competitive promotional environment.

Same-store sales of down 2% for the fourth quarter was in line with our guidance. Slight deceleration in January reflected tougher prior-year comparisons and the shift of a promotion into the holiday period at Zale. The fourth quarter GAAP operating loss of $84 million reflects a goodwill impairment, restructuring charges related to our Path to Brilliance transformation plan and a charge related to our previously disclosed regulatory matter.

We recognized a $287 million non-cash impairment charge in the fourth quarter of which $261 million is related to the R2Net acquisition with the remainder primarily associated with the Zale's trade name. The R2Net impairment is a result of revised long-term financial projections for James Allen as well as an increase in the discount rate, driven by higher risk premium used to value this business.

While the R2Net acquisition has enhanced Signet's digital innovation capabilities, the growth of this business has been lower than our initial expectations and has not yet reached profitability. A significant driver of the revised projections is sales tax implementation, which had a larger impact than we initially modeled in combination with a more competitive online marketplace.

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Our fourth quarter non-GAAP operating income of $241 million was in line with our expectations and declined $82 million or 290 basis points year-over-year. The decline over prior year reflects the following: One, the impact of lower sales; two, higher levels of clearance and promotion; three, a $13 million unfavorable year-over-year net impact related to the outsourcing of credit; and fourth, an $8.8 million charge related to unproductive inventory. These factors were somewhat offset by transformation net cost savings.

Non-GAAP EPS of $3.96 was slightly ahead of our guidance primarily due to a lower-than-expected tax rate. For further details of our fourth quarter results, please see today's press release.

Moving on to fiscal 2020 guidance. Our same-store sales are expected to be flat to down 2.5%. This guidance reflects continuing headwinds from our U.K. and James Allen banners and softness in Jared. Changes implemented in the third quarter of fiscal 2019 related to the timing of revenue recognition on our extended service plans will have an unfavorable impact of 20 basis points on our fiscal 2020 same-store sales.

Turning to operating income. We are aggressively addressing our cost structure and expect to deliver $60 million to $70 million of net cost savings in fiscal 2020 recently balanced between gross margin and SG&A.

Our gross savings are expected to be higher versus fiscal 2019, with higher levels of reinvestment and eCommerce and innovation resulting in somewhat lower net savings versus fiscal 2019. The first quarter will be the smallest quarter for net cost savings as payroll and facilities consolidation savings do not begin to impact our results until mid-second quarter and procurement savings are more second half-weighted.

We continue to expect $200 million to $225 million in net cost savings over the course of our three-year transformation plan, inclusive of the $85 million we achieved in fiscal 2019. Due to the significant increase in our tax rate this year, we are providing non-GAAP operating income dollar guidance of $260 million to $300 million to assist in fiscal 2020 modeling.

Our operating income guidance range embeds: One, incremental clearance activity to drive cash and lower our inventory levels; two, sales banner mix; and three, the profit impact of timing adjustments due to the recognition of high-margin extended service plan revenues. Additionally, we expect advertising expense to be slightly lower year-over-year for the full year with variability in the quarters as we move our spend to a more always-on model.

In fiscal 2020, we expect the year-over-year net impact of credit outsourcing to be flat to a modest headwind. As a reminder, our credit expenses have a variable component, driven by the level of credit sales for year. Our estimated net operating income impact from credit reflects our fiscal 2020 sales guidance with a slight decline in payment plan participation rate. As a reminder, the credit outsourcing business model change is fully anniversaried when we lapsed the non-prime credit outsourcing late in the second quarter fiscal 2020.

We also expect interest expense of approximately $42 million to $46 million. Our GAAP EPS guidance of $1.86 to $2.66 includes $55 million to $70 million in charges related to our transformation plan. Non-GAAP EPS guidance of $2.87 to $3.45 excludes these charges. Our non-GAAP EPS guidance embeds a tax rate of 16% to 17.5%, including discrete items. As Gina mentioned earlier, our fiscal 2020 guidance assumes no share repurchases.

Now moving on to the first quarter guidance. In the first quarter, we expect same-store sales to be down 0.5% to down 1.5%. The same-store sales guidance reflects a favorable impact of 40 basis points related to a planned promotional shift into the first quarter from the second quarter at Jared and an unfavorable impact of 45 basis points related to the extended service plans that I've previously discussed.

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With respect to profits, we expect non-GAAP operating income of $3 million to $10 million. Operating income in the first quarter will be impacted by: One, incremental sales; two significantly higher year-over-year advertising expense; three, the extended service plan headwind I discussed earlier in my remarks; and four, the year-over-year net impact of credit outsourcing is expected to be slightly positive in the first quarter due to a comparison against two months of bad debt expense in the prior-year quarter.

Our GAAP EPS guidance of a loss of $0.54 to a loss of $0.78 includes expected restructuring charges of $22 million to $28 million. Excluding these charges, our non-GAAP EPS guidance is a loss of $0.17 to a loss of $0.28, driven by lower levels of operating income and higher year-over-year interest expense. Given the small expected tax expense for the first quarter, we have provided a dollar range of non-GAAP income tax expense of $0.4 million to $1.4 million, which is inclusive of discrete tax items anticipated in the quarter.

Finally, turning to cash flow and capital allocation. In fiscal 2019, we generated adjusted free cash flow of $119 million, excluding proceeds of $445.5 million from a nonprime credit outsourcing transaction, driven by lower operating income versus prior year and investment in bridal inventory and a new fashion merchandise.

We ended the year in an elevated inventory position and do expect inventory to be up year-over-year in the first quarter. As we continue to work through legacy products, we do expect to reduce our inventory position by the end of fiscal 2020.

Our capital allocation priorities are to invest in the business for strategic growth and support our dividend. In fiscal 2020, capital investments of $135 million to $155 million will consist of limited new store openings, targeted store remodels and IT investments. This morning, we announced that we are maintaining our quarterly dividend of $0.37 per share and do not expect to repurchase shares in fiscal 2020.

With respect to leverage, we ended fiscal 2019 with a leverage ratio of 4.3 times. We now expect our leverage ratio at the end of fiscal 2021 to reach approximately 3.5 times.

And now, I'll pass the call back to Gina for some closing remarks.

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

Thanks, Michele. As you may have seen from our announcement a few weeks ago, we are very excited that Joan Hilson will be joining us as our new Chief Financial Officer effective tomorrow. Joan has significant financial and operational experience, working at a number of retailers, most recently as the CFO of David's Bridal. I am confident that she will bring valuable perspective to Signet and our transformation efforts. I would like to thank Michele for her many contributions to Signet and wish her well in her future pursuits.

We also filed an 8-K this morning, announcing the departure of our President and Chief Customer Officer, Seb Hobbs on June 30, 2019. I would also like to thank Seb for his very many contributions to Signet.

And now we are ready to begin the Q&A session.

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator instructions] Your first question comes from the line of Simeon Siegel from Nomura Instinet. Please go ahead.

Simeon A. Siegel
Analyst, Nomura Instinet

Q

Thanks. Hey, guys. Good morning.

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

A

Good morning. Hi, Simeon.

Simeon A. Siegel
Analyst, Nomura Instinet

Q

Gina, just recognizing – hey, guys. Recognizing the significance of Q4 in the business model, what is the Q4 EPS you're embedding in the full year guide? Maybe help at all with the cadence of the first three quarters.

And then, just a question we get a nice amount. Can you help – what percent of sales did the CarVal and Castlelake tranche represent this year? And maybe what do you think that will be this coming year?

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.

A

Hey, Simeon. This is Michele. So maybe I'll start and then if Gina has anything incremental to add, she can. In terms of – it sounds like you're looking for some color or numbers in terms of the fourth quarter EPS guidance. And clearly, we're not at a position that we're going to do that. We provided our full year guidance and we also provided the guidance for Q1. And including the EPS guidance, we did provide, as I mentioned on the call, operating income to also help facilitate the modeling.

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

A

But maybe what I can do is provide some strategic color on how we're thinking about Q4 this year relative to last year. So as I mentioned in my remarks, we did a deep dive analysis on all of fiscal 2019 with particular emphasis on the holiday period. So we saw some slight improvements versus the previous year, but obviously did not deliver the results that we were expecting or that we wanted to in Q4. And we have a lot of learnings that will come through in this year.

So, for example, we think one of our competitive advantages is in being able to understand customers and how they shop, particularly around key holiday periods. And we've identified that there are different shopping behaviors that are occurring in those periods. And we are targeting in a better way this year both our products and our promotions in order to help to access this more value-oriented shoppers.

I think another thing that we're doing is really building our off-holiday business through again our proprietary jewelry category data analytics. I mentioned targeting customers an important gifting times of the year like

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birthdays and anniversaries. We would call those more milestone gifting occasions as opposed to just holiday gifting occasions, which are areas where we think that we have a right to uniquely win.

Simeon A. Siegel
Analyst, Nomura Instinet

Q

Gina, [indiscernible] (31:42) yeah, sorry.

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

A

Go ahead.

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.

A

No, go ahead, Simeon.

Simeon A. Siegel
Analyst, Nomura Instinet

Q

I was going to say, just maybe taking a step back and reflecting on the work that you've done, just thinking about the comp declines. Do you have a view on where the customer – is the customer going somewhere else or simply not making a purchase?

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

A

It's more and more a highly competitive environment. We've seen that escalating over the last number of years with a fair amount of discounting, particularly during the December holiday period. But our data is indicating that the jewelry category remains a growing category that customers are continuing to look at jewelry as an important holiday purchase, as well as a purchase for some of these other milestone occasions.

And one of the growing parts of the category is women buying jewelry for themselves. And so all of these things are things that as we think about our product assortment and our revised marketing plan, we'll be going after those growth opportunities in fiscal 2020.

Simeon A. Siegel
Analyst, Nomura Instinet

Q

Great. Thanks. And then, Michele, were you going to follow up on that, the CarVal and Castlelake tranche, if at all possible?

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.

A

Yeah. I believe, Simeon, your question was what percentage related to Zale. And so we had said at the time that transaction was really focused on our Kay and Jared banners. And so I think if you go back and if you look [indiscernible] (33:14).

Simeon A. Siegel
Analyst, Nomura Instinet

Q

I just meant sales, not Zale.

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Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.
A

I'm sorry on what?

Simeon A. Siegel
Analyst, Nomura Instinet
Q

Sales, not Zales. Just in other words, how large is that business?

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.
A

The sales. I thought you were saying Zale. Yeah, I would just refer you back to the information we said at that time and we're not going to get into parsing out the percentage of sales. But I think if you go back to previously comments that we made related to the transaction, you can get to an idea of what that percentage was.

Simeon A. Siegel
Analyst, Nomura Instinet
Q

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

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

Thank you.

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.
A

Thank you.

Operator: Your next question comes from the line of Ike Boruchow from Wells Fargo. Please go ahead.

Ike Boruchow
Analyst, Wells Fargo Securities LLC
Q

Hi. Good morning, everyone. Thanks for taking the question. I guess, Michele, a question for you. I think in your prepared remarks, you talked about elevated inventory position to start the year. I guess, can you help us understand a little bit more color around that, maybe what type of merchandise are you referring to? Is it weighted to anyone banner? And then how should we think about your inventory position to start the year in relation to the gross margin in Q1? And then, maybe gross margin progression through the year?

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.
A

Yeah. So I'll start with some comments. You're correct, Ike, in my prepared comments I had discussed the inventory levels that particularly related to Q1 and embedded with the guidance we gave, we do anticipate year-over-year to have higher inventory as we are working through some of the legacy product collections. And selling through, we do anticipate to have some higher clearance level and that's all factored into the guidance that we gave as part of Q1 and embedded into the operating profit numbers we provided as well.

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And then, I also mentioned as we progress throughout the year, we'll be working through and selling down that inventory. So by the time that we do end our fiscal 2020, we expect that our inventory levels will be in a much better position. And that's been a key focus as we move throughout the year. One in part of just moving though the inventory, but also focusing on the cash side of it.

Ike Boruchow
Analyst, Wells Fargo Securities LLC

Q

Okay.

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

A

Yeah. I'll just add a little color on that as well. So we spoke previously about two areas in which we were investing in inventory, kind of coming to the holiday season. One was in bridal. We began that investment over the summer and we saw bridal growth across the business. In fiscal 2019, we believe that we're getting to a much better mix of offerings on trend and in our big flagship brands, Neil Lane, Vera Wang Love and Disney Enchanted.

And then, the second area that we made some investments are in more proprietary fashion designs and those performed well over the holiday period. The examples I gave in my prepared remarks is the Love + Be Loved collection, which we rolled out in a limited number of stores. It performed very well and so that will become a focus of some of our marketing around Mother's Day. Just continuing to build those exclusive and proprietary lines that differentiate the offering that we have at Signet.

Ike Boruchow
Analyst, Wells Fargo Securities LLC

Q

Got it. And then just to reconcile, the Q1 and the full year guide, is there some help you can give us on how this impacts the gross margin? Or how should we be thinking about the gross margins?

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.

A

The comment I would make is you know we don't give guidance. The color that we provided as we had called out particularly in Q1 elevated levels of clearance. All of that is factored into our guidance. And that's also in part why we did provide you the EBIT to help in your modeling.

Ike Boruchow
Analyst, Wells Fargo Securities LLC

Q

Got it, okay, fair enough. Just then the second question, looks like the credit losses – or the impact on EBIT from credit in Q4 was a little bit worse than what you had planned. Can you just – and the outlook for next year is again a little bit worse than what you had said prior to this. Help us understand the moving pieces there, why exactly did that take place? And just kind of what's going on there? And what are the drivers of that?

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

A

Yes. So in terms of the costs related to the outsourcing of the credit, there is a number of variables that go into that consideration and factors that influence that. One of them being that I called out on the call, it really becomes a variable cost and is depending on the level of credit sales. So far credit sales over-performed compared to our expectations, you are going to have some incremental expense as well as it can also relate to promotional mix

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[indiscernible] (37:38) as well as just mix between our prime and our sub-prime. So all of those factors have been considered as we've given the guidance out into FY 2020. And I did mention that in FY 2020 that we do anticipate the payment participation rate to be slightly decline over fiscal 2019.

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, Ike.

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.

A

Thanks, Ike.

Operator: Your next question comes from the line of Lorraine Hutchinson from Bank of America Merrill Lynch. Please go ahead.

Q

Hi, this is [ph] David Buckley (38:10) on for Lorraine this morning. Thanks for taking our question. Just move quick back to the gross margin, can you quantify the benefit that you expect to see in the first quarter from lapping bad debt expense? And then can you also comment on James Allen's performance in the fourth quarter and your outlook for 2020? Thanks.

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.

A

Yeah, I'll start with the first one. In terms of the gross margins and we did call that out that we are going to have the benefit that the prior year Q1 had included two months of bad debt expense. I don't have that with me, but if you go back and if you look at our Q1 filing, you'll see a bad debt expense and you can probably come up with the impact – and the positive impact that will have in Q1.

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

A

Okay. And then I'll take your James Allen question. So we did see James Allen growth slow substantially as we came through the year and began collecting sales tax in a number of markets. By the end of fiscal 2019, we were collecting sales tax in just under about 50% of sales so states that represent about half of James Allen sales. We expect that headwind to continue as we pick up some additional large states during fiscal 2020. And by the end of fiscal 2020, we'll be collecting sales tax in states probably representing around two-thirds of James Allen sales.

We do have though say a couple of things. We have some really important efforts going on on James Allen right now. We are adding jewelry fashion products to our line. And that is a now growing part of the business that is a higher margin business for us. So we feel excited about the opportunities that we have there. We also have added some service plans on James Allen. So another opportunity for us to add value for our customers. And

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we're doing a lot of work on our algorithms and the technology and customization tools, which really are the competitive advantage of James Allen to make sure that we have a best-in-class customer experience.

So it's a combination of the headwinds we expect to continue to see on sales tax, somewhat offset by some of these growth initiatives that we're very rapidly putting in place.

Q

Great. Thank you.

Operator: Your next question comes from the line of Paul Lejuez from Citi Research. Please go ahead.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Hey, thanks, guys. Can you maybe break down the $60 million to $70 million of savings for 2019, or if you can maybe even talk about it on a growth business? And then, what are those offsets of investments that you plan to make one of the buckets there as well? Also, curious on the James Allen business. What is the current carrying value of that asset? This write-down that you just took, does that basically write down the James Allen asset to zero? Or is there still a carrying value on that asset? And then, last, any changes for this upcoming year on the discount rate on the sub-prime receivables? Thanks.

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

A

So why don't I take the first question on cost savings. So we don't guide to gross cost savings, but you're absolutely right we said that we'll have net cost savings of $60 million to $70 million in fiscal 2020. That's on top of the $85 million of net savings that we delivered in fiscal year 2019 and on track for the $200 million to $225 million that we expected across the three years.

Our real focus this year on cost savings is direct and indirect procurement, consolidation of facilities, payroll savings and lowering our corporate costs. All of these are areas where we've identified opportunities that fit very well with our strategy of building a Culture of Agility and Efficiency, simplifying decision-making so that we can move bolder and faster on our initiative.

And our cost savings has always been targeted to allow us to fund growth, right? I mean, the get back to growth is a key cornerstone of Path to Brilliance. So the investments that we'll be making are really in driving eCommerce, innovation and the mobile experience that customers have. So we move ahead on our first two strategies Customer First and building our seamless OmniChannel experience for customers.

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.

A

Paul, maybe I'll pick up your two other questions. I think the second question you had related to James Allen and the noncash impairment charge we had recorded in Q4. And was that 100%, the goodwill and intangible balance we had or is it residual piece. It is not 100% of the intangible value that we had recorded prior to the impairment charge. You'll see we'll be filing the 10-K at some point later today. So there is a residual piece. It was a substantial portion of it, I want to say maybe 80% or so of balance was written off based on the revised projections and the higher discount rate driven by the risk premium.

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Your third question, I believe, related then with the MDR rate, related to our credit outsourcing. So, again, just what I mentioned in the prepared remarks is that we do expect credit outsourcing to be flat to modest year-over-year headwind to our operating profit for fiscal year 2020. That guidance embeds our view on the MDR rate, as well as, as you would imagine, there are several other variables, including the overall credit sales, the mix between prime, sub-prime, as well as promotional mix within our prime. We've said previously the MDR rate, it is subject to periodic adjustments and it could change, but everything has been factored into the guidance that we provided.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Michele, how often does that change?

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.

A

It's a periodic adjustment. So I said before, it's not subject to monthly changes. And there is a number of factors that are involved if that rate was going to change.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Thanks. Good luck.

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.

A

Thank you.

Operator: Your next question comes from the line of Oliver Chen from Cowen. Please go ahead.

Oliver Chen
Analyst, Cowen & Co. LLC

Q

Hi. Thank you. We had a question about the product assortment ahead. Where do you see the most opportunities? And how will this interplay with traffic and your thoughts on the best strategies to prioritize, driving more consistent traffic? We'd love your views there. Thank you.

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

A

Hi, Oliver, thanks for that question. So on product, we really have taken a good hard look at our product strategy. And there are three key areas that we're prioritizing as we go into fiscal 2020. We laid some of the groundwork for this in fiscal 2019, but we'll be able to move, I think, bolder and faster into it this coming fiscal year. Those three strategies are building iconic flagship brands.

Good examples of ones that have been working for us are Vera Wang Love, Neil Lane and Disney Enchanted and also some of the proprietary brands that I talked about. We have developed a new customer testing methodology so that we are screening more new ideas faster. And that will allow us to bring on more of these iconic flagship brands that we can holistically market through a digital social and TV program, as well as new fashion initiatives.

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And then, if I just kind of shift into fashion a bit, we also as the two other points of our merchandising strategy see how important it is for us to have good offerings, really competitive offerings for the value-oriented shopper, especially around key holiday periods, and to have a higher mix of on-trend product. So we have excellent vendor relationships. We are looking across the world for great trends to be able to bring to our customers. And I think we haven't been leveraging that competitive advantage historically as much as we will going forward.

Oliver Chen
Analyst, Cowen & Co. LLC

Q

Okay. And I know you've really dedicated a lot of effort thinking about Generation Z and millennials. A couple trends we're seeing is the rise of the on-demand economy and jewelry-as-a-service, as well as some added transparency from search engines online. Could you just give us your thoughts about how you're thinking about those [ph] as they apply to (47:23) the new customer and how Signet can remain agile in a time of change?

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

A

So bridal remains an incredibly important part of our business and while we see customers of all ages getting engaged, it really does skews to that younger Gen-Z and millennial target audience. So it's one that we spend a lot of time with. One of the great foundational capabilities that we got in place in fiscal 2019 is really understanding the details of the customer journey. So being able to dissect that in a bridal context and how our customers are acquiring information, what they expect from selection, the kind of curation that they expect in-store and online, time is an incredible important commodity to these customers.

And so how do we make sure that we are fast and allowing them to get the information and the selection that we really want. So I think that's very much a part of it. That's a lot. That's behind our shift to a more digital and social media platform and leveraging our data to better target messaging to people when and where they need it. We also have given our size and scale have developed some proprietary relationships with a number of the different social media channels and believe that we can leverage those to make sure again that we are creating community among these target audiences.

And then, the final thing that I'll mention is Signet continues to be a leader in corporate and social responsibility. We'll be publishing our CSR report next week. And I hope you all take a chance to read it, because I'm very, very proud of the stance that we've taken on responsible sourcing, on environmental sustainability, on diversity and inclusion in our organization and also on philanthropy. And we know that this generation of consumers is voting with their pocketbook for companies that really represent their values. And I believe that Signet is uniquely that company within the jewelry industry.

Oliver Chen
Analyst, Cowen & Co. LLC

Q

Thanks for those comments. Best regards.

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

A

Thank you.

Operator: [Operator Instructions] Your next question comes from the line of Dana Telsey from Advisor Group. Please go ahead.

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Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Good morning, everyone. As you think about the legacy products and the weakness there, how you plan up for fiscal 2020, new collections or introductions we should be watching for? And then, on your real estate portfolio, in the shift from mall to off-mall, impact of occupancy costs, what percentage of your real estate you expect to be in off-mall going forward? Thank you.

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

A

Hi. So let me take both of those questions and then Michele chime in with any details. I think one of our biggest learnings over the last year-and-a-half since I've been here has really been the pace of change and customers' appetite for new and different. So product life cycles that might have been four or five years in the past are shorter than that now. And so what we're really developing is better predictive capabilities, so that we can more quickly understand where we are in that product life cycle and move through it and have other new offerings in place.

I mentioned, for example, that one of the legacy – actually two important kind of legacy product collections that negatively impacted our business in fiscal 2019 and particularly holiday were beads and Ever Us, those are examples of things we did not move through fast enough from a product life cycle standpoint and we've learned from that and we'll be better prepared to do that in the future. I think from a real estate footprint standpoint, we've been aggressive in optimizing our real estate portfolio.

And as I mentioned in my remarks, it's really to meet customers where they are and create that ideal OmniChannel experience for them. But as we rationalize that store footprint, we are better able to target investments in creating a more digitally-enabled and more curated stores experience.

More and more our customers are getting and understanding our selection online before they ever come into our stores about 70% of our customers now have already shopped one of our online sites before they walk in the door. So they understand already a bit about our selection. What we want to do is help them understand more about our expertise and our service to really help them to find the right products once they get into store and we can do that through a combination of our outstanding store staff and expertise, but also more digitally-enabled footprint. We have seen better performance from our off-mall locations. And so we have been moving systematically out of lower performing malls and simplifying by moving out of regional banners.

So I am feeling very good about the work that we've done moving out of over 260 stores in fiscal 2019, and we're guiding to moving out of another 150 in 2020. Some of those that will be replaced by great off-mall locations that we've identified based on our trade market data analytics.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Got it. Thank you. And just one quick follow-up. What was -you've given the impact of [ph] store closure on sales (53:30) how did that help or hurt [Technical Difficulty] (53:33) income? And how do you look at it go forward? Thank you.

Michele Santana
Chief Financial Officer, Signet Jewelers Ltd.

A

So, Dana, it's Michele. When we think about the impact of store closures on – from a total sales and how that flows to the bottom line, one of the items that we had talked about is our sales transference rate that we've been

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very focused that when you look at the stores that we're closing and the geographic ring that's around that where we have either another banner or a sister banner, we've been pretty successful in capturing a sales transference rate to mute impact to the bottom line.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Thank you.

Operator: There are no further questions at this time. This concludes today's conference call. Thank you for participating. You may now disconnect.

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