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Signet Jewelers Ltd. (SIG)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to the Signet Jewelers Second Quarter Fiscal 2021 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded. I would now like to turn the conference over to Vinnie Sinisi. Please go ahead, sir

Vincent J. Sinisi

Senior Vice President-Investor Relations, Signet Jewelers Ltd.

Hey, thanks very much Alyssa and good morning everyone. Welcome to our second quarter earnings conference call. On the call today are Signet's CEO, Gina Drosos; and CFO, Joan Hilson. During today's presentation, we'll make certain forward-looking statements. Any statements that are not historical facts are subject to a number of risk and uncertainties, and actual results may differ materially. We urge you to read the risk factors, cautionary language and other disclosure in our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. 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'll discuss certain non-GAAP financial measures. For further discussion of the non-GAAP financial measures as well as reconciliations of the non-GAAP to most directly comparable GAAP measures, investors should review the news release we posted on our website at www.signetjewelers.com/investors.

And with that I'll turn the call over to Gina.

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

Thank you Vinnie. Good morning, everyone and thank you for joining us on our second quarter call this morning. Recall that in Q1, as stores closed, we pivoted to a digital-first strategy and accelerated many elements of our

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Path to Brilliance transformation. At the same time we tightly managed cash and expenses to offset negative impacts of the COVID-19 pandemic and preserve our ability to invest in and grow our business. Now, in Q2, we are seeing our strategic efforts yield results. Before I discuss our Q2 results, I want to first acknowledge and thank the Signet team. I am inspired everyday by our team's agility of operate in this new retail environment and meet our customers' needs. Guided by our purpose and core values, safety and the well-being of our team members and customers remains a top priority. This is why we've launched our Love Takes Care safety program this quarter in partnership with leading healthcare experts to ensure that we are doing everything possible to create safe places to shop and work. Our team's care and compassion fueled the launch of our Signet Team Member Relief Fund for our colleagues most impacted by COVID.

We activated our voice and partnered with the NAACP legal and defense fund to fight racism as well as supported GLAAD to call for equality and justice for all. We are resilient and I want to whole heartedly express my gratitude to our Signet team. Along with our vendor partners and loyal customers, our team is at the core of my belief that we will together emerge from this crisis stronger.

I'd like to now discuss our Q2 results as well as provide additional strategic perspective on how we are learning and using this dynamic environment to accelerate our transformation and position ourself for long-term competitive advantage. Same store sales for the second quarter were down 31.3% reflecting stores being closed for much of the quarter, including our Mother's Day selling period. Despite continued effects of the worldwide pandemic, we drove sequential sales improvement month-over-month and same store sales turned positive in mid-July as store re-openings reached scale. We achieved this while driving high double-digit eCommerce growth in Q2 and this momentum continued into Q3. We leveraged our cost diligence and cash preservation to protect liquidity as well as fund increased investments in digital and eCommerce distribution. Though the macro environment remains uncertain, we have flexible new capabilities in place and are prepared to serve our customers this holiday season wherever and however they choose to shop.

Turning first to digital, Signet drove eCommerce sales of 72% in Q2 versus the prior year quarter. This was led by eCommerce growth of 99% in our bricks and mortar banners while James Allen continued to experience some manufacturing disruptions, especially in May. In Q1, we established a dedicated virtual selling team and in Q2 we scaled this team and also trained more than half or 15,000 of our store team associates to use virtual selling tools from in-store and from home. In Q2, our jewelry consultants booked more than 300,000 individual appointments comprised of virtual, videoconference and curbside consultations and these appointments are generating both higher conversion levels and higher average transaction value than historical eCommerce transactions.

We've achieved new levels of eCommerce sales penetration. For perspective, over the last four years we've more than doubled our eCommerce penetration, growing from roughly 5% to 12% last fiscal year. During Q2, eCommerce penetration was 30%. Though we recognize COVID-19 magnified eCommerce penetration this quarter due to the temporary closure of many stores, we're seeing elevated levels continue even after our store openings reached scale in July, with August eCommerce penetration still heightened at roughly 20%.

This reinforces our belief that Signet's store footprint combined with recognized jewelry expertise and new virtual selling capabilities is a strategic competitive advantage in the jewelry category where trust and counseled selling is important, especially in bridal. Given the trajectory of our eCommerce sales, we've expanded distribution throughput dedicated to online orders to 5 times that of holiday last year to be ready to meet this year's holiday demand.

Turning to real estate, as we continue to optimize our footprint, we moved quickly and have already closed 293 of the 380 planned closures we announced for this fiscal year, substantially all of which were traditional mall

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locations. With these closures, we have reduced our store count by 19% since fiscal 2017 year-end. We continue to reduce exposure to lower traffic malls and shift toward off-mall locations, which typically offer lower occupancy costs with better performance. We continue to take a hyper-local and data-driven approach which allows us to transfer sales from our closing stores as well as from competitors' store closings to our other physical locations or virtual channel.

Last quarter, we mentioned testing multi-banner locations. As a first priority, we tested James Allen store-in-stores within Jared locations. Given positive sales results and strong traffic gains, we plan to expand this new format to over 80 locations or one-third of our Jared's fleet prior to holiday. This is a terrific way to create a curated physical presence for James Allen while maximizing our existing off-mall space and staffing in Jared.

Turning to merchandising, during Q2 we worked with our vendors to strengthen our core assortments and invest in new and earlier product launches across our banners for holiday. To further support eCommerce sales, we have also extended our online assortments as well as search and browse capabilities in anticipation of more holiday transactions occurring online this year.

In marketing, we've implemented new capabilities in customer prospecting, specifically focused on trade areas where department stores and independent jewelry retailers are closing. By further shifting our focus to digital, we believe we're able to more precisely and efficiently target current and new customers, and provide them with relevant and engaging content. To amplify our marketing efforts, we've been successful in launching influencer and social programs to extend the reach of our content as well as instituting robust consumer PR to continually be top of mind and maintain cultural relevance. As a result, our website traffic is increasing.

Turning to cost savings and liquidity, as we continue to optimize our store footprint, our company's workforce needs are also changing. While personnel decisions are very difficult, we had a reduction in force this quarter that was driven both by our reduced store count and our pivot to increasing digital capability needs. These decisions were made thoughtfully to better align the workforce to a more streamlined structure and digitally focused culture.

We remain on track to achieve over $100 million of net structural cost savings as we discussed last quarter. These savings efforts both bolstered our liquidity levels as well as contributed to positive free cash flow this quarter, which we believe provides us the ability to both better manage uncertainty and also accelerate strategic investment.

So, all in all, I'm pleased with our continued progress in Q2 to manage cash and liquidity effectively, gain traction and scale with our new digital capabilities, and get stores opened safely and quickly leading to improved same store sales throughout the quarter and into Q3. While the months ahead are full of uncertainty, we are prepared to serve our customers effectively however and whenever they want to shop this holiday season and beyond.

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

Joan Holstein Hilson

Chief Financial Officer, Signet Jewelers Ltd.

Thanks, Gina. Hello everyone. This morning I'll provide details regarding our performance to help you better understand the trends we saw as the quarter progressed. By month, same store sales were down 68.5% in May, down 21.8% in June and down 1.3% in July. This included not only brick-and-mortar momentum as stores reopened to scale but eCommerce remained strong with 72% sales growth over Q2 last year. Strength continued into August with preliminary same store sales up 10.9% which includes 65.2% growth in eCommerce versus August of last year.

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Due to COVID-19, our design and service centers were closed until later in the quarter. Because of this, revenue recognition related to our extended service plan programs was lower than last year and negatively impacted same store sales by roughly 450 basis points. We expect some portion of this revenue to be recognized later in the year. However, we cannot estimate the amount due to the uncertain impact COVID may have on consumer behavior and our ability to keep stores open.

Our Q2 gross margin of approximately $224 million, or 25.2% of sales, declined largely due to a deleveraging on fixed costs resulting from lower sales as well as the extended service plan revenue discussed earlier. The rate decline was partially offset through structural cost savings, lower occupancy costs and inventory related costs. SG&A was approximately $266 million, down $145 million to last year. The improvement to SG&A was primarily driven by lower labor and advertising expenses.

Non-GAAP operating loss was $41.7 million and excludes pre-tax charges of $20.3 million related to impairment of long lived assets as well as $28.7 million in restructuring charges related to the Path to Brilliance transformation plans. Interest expense for the quarter was $9.4 million, down roughly 7% year-over-year. Second quarter non-GAAP EPS was a loss of $1.13 compared to prior year non-GAAP EPS of $0.51.

Turning to Path to Brilliance cost savings, net structural cost savings are on track to exceed $100 million in fiscal 2021. Now in our third year of Path to Brilliance, though we originally targeted savings of $225 million over the three years, we now expect net savings of at least $285 million. These savings include workforce reductions related to our new operating structure in stores and support centers, direct sourcing, indirect spend and occupancy costs. The cost savings also resulted in one-time charges of $28.7 million largely consisting of cash payments for severance in the quarter.

Even though stores were closed for a good portion of the quarter, inventory was down $79 million to Q2 last year. The lower levels were driven by our use of inventory from permanent store closures to replenish active stores along with the sell-through clearance and improved inventory efficiency in core products. Inventory management, along with our continued cost diligence and working capital efficiencies, generated net cash from operating activities of $156.1 million at quarter end. We ended Q2 with $1.2 billion in cash and equivalents. Our liquidity position provides us with the ability to accelerate our digital transformation and create new virtual experience for shoppers. As such, we now expect capital expenditures to be approximately $85 million compared to $143 million last year. Subsequent to quarter end we paid down $100 million of our ABL reflecting the impact of inventory level fluctuations on our borrowing base.

Turning to our financial services, over the last few years we have enhanced our suite of financing products to including leasing and one-time use [ph] flip pay (00:16:07) product in addition to our private label credit card program. We are extending the availability of all of our financial service offerings and our extended service plans to our online channel ahead of holiday.

Turning to the non-prime portfolio, we mentioned last quarter that Signet began purchasing new receivable accounts and at the end of Q2, these receivables aggregated $17.2 million on our balance sheet net of allowances. The size and early performance of these new accounts has been within our expectations. Ultimately, our goal is to provide our customers with a wide breadth of financing options to assist in the purchase of jewelry and ensure that we prudently manage (sic) [maximize] our potential sales capture across our banners.

In closing, we are incredibly proud of all our team members for their agility to pivot and deliver with excellence, service to our customers using new digital tools. Our team came together to prioritize investments, effectively

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managing working capital and preserve our liquidity. Importantly, we are seeing our customers respond positively to our efforts and we look forward to serving them in the upcoming holiday season.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] The first question today comes from Paul Lejuez of Citi. Please go ahead.

Tracy Kogan
Analyst, Citigroup Global Markets, Inc.

Q

Thanks. It's Tracy filling in for Paul. I had two questions. First, I was wondering if you could tell us what you're seeing from your eComm customers. I think you mentioned the conversion was higher and the basket was higher, but I was wondering are they buying different categories and what does the customer look like in in terms of demographics, if it's a new customer, and I guess prior to that if you could say whether you're getting more of a new customer or an existing customer there? And then secondly, as you look toward holiday, I wonder if you could give us a sense of the newness you expect in your collections this year versus last year. Thanks.

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

A

So, I'll take the first question on eCommerce. It's been very interesting. So jewelry has traditionally not been a category that's very well developed in eCommerce, maximizing and kind of leveling out at about 15% of sales. We've been able to break through that in the quarter, of course, in part because stores were closed, but also using our new digital selling tools.

The other things that are changing are that jewelry was traditionally a lower average retail price purchase online, we're seeing higher average transaction value in this quarter than we have seen in the past. It's particularly higher when those virtual sales are consulted sales. So the over 300,000 appointments that we did with virtual consultants have a higher average transaction value even in this quarter than a normal eComm purchase. And we're definitely seeing more new customers. 40% of purchases this quarter came from new customers, many of those online. And our customers that are purchasing are typically younger and more multicultural than we've seen before.

So we're working very hard to continue to improve our digital experience. We think our new marketing tools and prospecting, especially as some other jewelry retailers are struggling, gives us a tremendous opportunity for new customer acquisition and potential for longer term share gain.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

So with respect to newness Tracy, we continue to see that we will have a consistent penetration of newness to last year, but importantly, what we've been able to do with our supply base is work with them to postpone some of our Mother's Day launches, bring those in earlier in the season in the third quarter, as well as work with them to ensure that we have our orders and get supply for the higher holiday selling season. So we also have new launches – more new launches within that penetration, so we're feeling good about our ability to bring newness to the customer this coming holiday.

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

A

I'll just add on that, one of the things that we've really focused on as part of our customer-first strategy within Path to Brilliance is getting kind of proprietary customer data and our data indicates that 51% of jewelry customers are planning to shop earlier this holiday season than they have in the past, so we'll be ready for that.

Tracy Kogan
Analyst, Citigroup Global Markets, Inc.

Q

Thanks. Just one follow-up on your comments that 40% of I think your eComm customers were new, did you mean new to Signet concept overall or just new to eComm [indiscernible] (00:21:36)?

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

A

New to Signet overall.

Tracy Kogan
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you.

Operator: The next question comes from Lorraine Hutchinson of Bank of America. Please go ahead.

Lorraine Hutchinson
Analyst, Bank of America Merrill Lynch

Q

Thanks, good morning. I was hoping that you could comment on trends you're seeing in bridal both as the quarter progressed and then also if customers are seeming more willing to buy bridal, particularly engagement online versus prior periods?

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

A

So, I'll start on that one and then Joan you can jump in. We saw month-on-month improvement across the quarter in all of our folios including bridal. I would say bridal has been a particularly strong category for us online, especially as we have been able to bring counseled selling at scale, but it's also been stronger in store, younger men are the most optimistic consumers right now and most interested in going back in stores. We're also seeing strong engagements happening. So our research indicates that over 50% of pre-engagement couples decided to quarantine together during COVID-19, and half of them say their relationship got stronger during COVID-19 with only 7% saying that that their relationship worsened, and that's really we think a nice tailwind in our bridal business. We're also seeing higher AUR in the bridal business in part because of our online consultation.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

What I would add to that is we saw that continue as well into August. And interestingly we're seeing our best performance in some of our bigger brands which include Neil Lane, LeVian and Vera Wang and we also continued to be pleased with the performance of the Chosen line at Jared.

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

A

We saw – we've really upped our game over the last year in creating custom offerings for our customers. So now on Neil Lane and Vera Wang, for example, you can choose the diamond, choose the setting, really create a bespoke piece and so that's also been part of the driver in our strong bridal business.

Lorraine Hutchinson
Analyst, Bank of America Merrill Lynch

Q

Thanks, and then as you think about holiday, there will clearly still be some traffic constraints within your stores, and you spoke about your customers they may shop earlier, so what are the changes you're making to ensure that you can handle the types of volumes you usually see during those key holiday weeks and you can try to spread those out?

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

A

Look, I think – I mean there is a lot of uncertainty in the back half of the year [indiscernible] (00:24:32) resurgence of COVID, customer demand for more discretionary categories, the election, lots of things. So we've really focused on what we can control, which is being ready to be the jewelry company that can serve customers this holiday season. Number one our stores are safe. We have partnered with a leading healthcare authority and developed a proprietary program called Love Takes Care, which is really all about social distancing, both our store staff wearing masks and also complementary masks for customers and very frequent cleaning of high touch areas and every piece of jewelry. As Joan said earlier we have shipped in our holiday newness earlier, and we feel very strongly about that newness.

I think we've done a lot of learning over the last couple of years and very successfully last holiday to be more pinpointed in that newness and so that's ready. We've gotten our online business ready, our website are faster. They are easier to shop than they were a year ago. And as I mentioned in my prepared remarks, we've increased our eCommerce distribution capability, so that we can ship 5 times more packages this year anticipating that there will be more online sales. And then also, as I mentioned, we've been able to stand up virtual selling with more than half of our associates trained to be able to do that either from stores, if our stores are open, or from their homes if our stores aren't open. So we're ready and we're doing obviously a lot of work on new customer acquisition and prospecting to try to keep filling our funnel.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

The only thing I would add on to that, Gina, is that the flexible fulfillment work and the capabilities that we are investing in, 90% of our SKUs will be available for buy online, pick up in store for all of our US banners. And our Akron DC will be able to ship eCommerce orders, increasing capacity as Gina said, as well as we have automated ship from store product to our customers and in, not all of our banners, but have provided a more improved manual approach in the Akron banners. So that's a meaningful improvement for us.

And as we said, [ph] to enable (00:27:04) eComm purchasing, we've expanded our credit options and our extended warranty plans online as well. So we've put forth a lot of thought and a lot of effort into understanding how the customer may want to shop this holiday to prepare for them to shop however they would like to.

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Lorraine Hutchinson
Analyst, Bank of America Merrill Lynch

Q

Thank you.

Operator: [Operator Instructions] The next question comes from Dana Telsey of Telsey Advisory Group. Please go ahead.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Good morning, everyone, and nice to see the progress. As you think about holiday season, marketing spend, shipping costs, we've heard of earlier deadlines, how are you planning shipping costs, advertising this year as compared to last year? And also product introductions this year, how are they different this year than last year, whether it's in terms of category or timing of introductions? Thank you.

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

A

Hi, Dana. Thank you. So a couple of things I would say on that. One is earlier, so as I mentioned, we're getting our new products available in September online and in stores. In terms of newness, we're seeing a big trend toward more meaningful and sentimental jewelry. I think COVID-19 has really caused customers to focus on relationships in new and different ways religious jewelry has been trending. So we have new launches across all of our banners.

I'm really excited about the Journey collection that we have in Zales. Journey kind of showcasing that life goes on and that we are resilient through a period like this. We also have very strong launches of sentimental concepts in both Kay and in Jared. So I think we are adapting to this environment. I mentioned that we are strengthening our custom offerings. We're seeing people more often want to customize their jewelry, whether it's engraving or choosing a diamond and a bespoke ring setting for their partners, so that's another evolution that we've made. And I don't know if, Joan, you have anything to add to that.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

No, [ph] I haven't anything to add on the (00:29:35) shipping costs. We are aware of it. We have it in our plans and are working through that. We have – we see that as we mentioned bringing in products a bit earlier and working with our vendors on that timing just to smooth it out a bit Dana. And then with respect to marketing, we have an effective marketing mix. We believe that has a nice balance of digital, social and linear to serve our customers and make sure we're speaking to them wherever they are and at whatever time of day they need to. So, I don't know if Gina's going to add anything on marketing.

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

A

Yeah, I mean just to say that over the last couple of years we've really switched to more than always on strategy. So, while Signet used to spend the vast majority of our marketing in Q4, we've shifted to a much more balanced marketing message across the year and much more digital. So, we can do more with less via our customer data platform, our dynamic content optimization really getting the right messaging to the right customers at the right time.

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Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Thank you.

Operator: The next question comes from Ike Boruchow of Wells Fargo. Please go ahead.

Ike Boruchow
Analyst, Wells Fargo Securities LLC

Q

Hey, good morning everyone. Couple questions. So I'm sorry if I missed this. On the quarter-to-date, the 10.9%, did you break that out, stores versus eComm? I was just curious if there is any more color there. And then just on margins, I guess in August on those very strong sales, is there any commentary on merchandise margins, are they holding steady? Is there anything going on from a promotional standpoint?

And I guess the last question [ph] in this string of (00:31:25) apologies. Now that you've gotten these occupancy savings and the comps are positive, like should we begin to assume that your gross margins should be able to stabilize and maybe even begin to improve as we work through the back half of the year? Thank you.

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

A

So, Ike I'll take the first question. We did say that eCommerce sales held strong in August. I was particularly pleased to see that. So, we got to scale on our store re-openings by mid-July. We got to just north of 90% of stores open and eCommerce sales held at over 65% in August. So, to me, this is a reinforcement of our belief that it's the combination of Signet store footprint, our recognized jewelry expertise and these new digital capabilities which is a competitive advantage for us in the jewelry category, given customers' integrated shopping journey, which is both in-store and online and given the importance of trust and counseling, especially in bridal sales. Joan [ph] do you want to take the other... (00:32:34)

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

With respect to margin, as we mentioned in the prepared remarks that it declined largely due to deleveraging on fixed costs as well as most of those costs associated with the stores and distribution. It was also down this quarter on a merged margin levels as a result of our clearance efforts and a higher penetration this year than last year and we will continue to work through our plans and promote as we see appropriate throughout each quarter and at this time we cannot give guidance on gross margin but we remain committed to inventory discipline and inventory management and working on efficiencies and our core replenishment as well.

Ike Boruchow
Analyst, Wells Fargo Securities LLC

Q

Got it. Thank you.

Operator: Thank you and that was the last question. I would like to turn the floor to Gina Drosos for any closing comments.

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

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Great. Well, thanks everyone for joining us this morning. We're pleased with the progress we made in Q2 and are well prepared to serve our customers this holiday season and beyond. Again, to our Signet team members, we thank you for your extraordinary contributions and for your continued passion and commitment to our mission and core values and to everyone listening we wish you and your families continued health and safety. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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