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Signet Jewelers Ltd. (SIG)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Signet Jewelers Third Quarter Fiscal 2020 Earnings Call. At this time, all participants are in a listen-only mode. After the speaker's presentation, there will be a question-and-answer session. [Operator Instructions]

I would now like to hand the conference over to your speaker today; Randi Abada, Senior Vice President of Investor Relations. Thank you. Please go ahead.

Randi Abada

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

Thank you. Good morning, and welcome to our third 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 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 will discuss certain non-GAAP financial measures. For further 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 at www.signetjewelers.com/investors.

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. I want to begin by thanking all of our team members for delivering a solid third quarter and for providing an inspiring holiday experience for our customers.

I'll open my remarks with an overview of our third quarter results and then provide thoughts on the holiday season and progress on our Path to Brilliance priority. I'll wrap-up with some brief comments on our guidance before turning the call over to Joan for additional details on our quarterly results and commentary on our financial outlook.

We believe that our third quarter performance demonstrates that the cumulative progress on our Path to Brilliance transformation is positively impacting our results. The operational improvements we are seeing each quarter are contributing to higher Net Promoter Scores, improving traffic trends and better-than-expected financial results. While we remain mindful that we still have more work to do, we are pleased with the progress of our Path to Brilliance transformation efforts.

Here are some highlights of our third quarter results. We delivered total same-store sales growth of 2.1%, with brick-and-mortar same-store sales up in all US mall-based banners and double-digit growth in eCommerce sales.

North America same-store sales grew 2.9%, reflecting growth at Zales, Kay and Piercing Pagoda, with Kay's performance driven by a strategic decision to accelerate inventory reduction and make room for holiday newness.

James Allen returned to double-digit growth through new merchandise assortment and site enhancements, along with beginning to lap the implementation of sales tax. Once again, Signet's US traffic performance was ahead of ShopperTrak total retail traffic.

I want to give a special mention to Piercing Pagoda, which had its sixth consecutive quarter of double-digit same-store sales growth. Pagoda has made strong progress in enhancing its product offering and recently launched a successful first-ever advertising campaign. We are opening 11 new kiosks in the second half in top-performing malls to introduce more customers to this fast-growing and highly productive concept.

In the third quarter, merchandising efforts to expand our iconic flagship brands, increase newness and strengthen our core products continued to take hold. North America bridal and fashion each grew on a same-store sales basis in the quarter. Strong performance in flagship brands, Vera Wang, Neil Lane and Leo, drove bridal sales with fashion growth led by gold.

Our exclusive Love+Be Loved collection and diamond fashion, Enchanted Disney, showed continued strength in both bridal and fashion. In the UK, concerns over Brexit continue to negatively impact customer spending, contributing to a 5.2% decline in same-store sales.

Turning to profits, our efforts to bring greater efficiency to our operations delivered operating profit growth year-over-year and ahead of our guidance. This cost discipline funded important investments in advertising, eCommerce capabilities and growth initiatives during the quarter, and also allowed us to take actions to position inventory lower and make room for newness heading into holiday. Adjusted free cash flow was up \$243 million year-to-date, driven by operating profit growth and inventory efficiency.

Now, I'll turn to an update on our holiday plans within our core strategic priorities of Customer First, OmniChannel and Culture of Agility and Efficiency. Our holiday plans have been built around cumulative progress we have made toward our Path to Brilliance priorities and operational roadmap that incorporates specific learnings we gained last year and our view of the competitive environment.

Beginning with Customer First. We've significantly improved our merchandise offerings, improved the in-store shopping experience and transformed marketing and media effectiveness with improved customer insights and data analytics capabilities. We are continuing our efforts to scale up services.

In product, we are positioned with bigger branded product launches, a more inspiring broader selection of gifts and competitive price points for value-oriented shoppers. At Kay, new brands include the exclusive to Signet, Adrianna Papell contemporary bridal jewelry collection inspired by the special occasion dress designs of this popular brand, the Center of Me diamond fashion collection and Hallmark branded fashion collection.

We've expanded Neil Lane premier bridal and color gemstones. We are also amplifying our gold offerings and adding new designs including color to our successful in-house designed Love+Be Loved collection. Kay also launched a sparkling savings selection of gifts at key price points.

In Zales, new brands include Marilyn Monroe collection and the Art Deco inspired Zales' private collection and bridal. In flagship brands, we launched Enchanted Disney new Frozen II and Maleficent collections, and new gemstone bridal designs.

Vera Wang added new designs and launched new custom and men's fashion. Zales is also refreshing the exclusive past, present and future collection and building on its successful dazzling deals value-oriented gift offerings.

At Jared, we've strengthened our competitive advantage in bridal assortment with higher quality loose stones, more competitive prices and increased availability using our R2Net virtual inventory. Our efforts position Jared as a destination for custom-created rings, while also refreshing branded bridal assortments, including the exclusive Chosen collection.

In fashion, Jared has expanded gold and the shy fashion collection. And also recently began rolling out the premium John Hardy collection. Overall, we believe our product assortment is stronger this holiday season, across our new and existing iconic flagship brands, on-trend merchandise and value-oriented offerings.

Moving on to marketing, we are continuing to implement strategic changes to our marketing model with modernized creative, shifts in timing of spend, and mix of media.

These strategy changes are driving greater efficiency and effectiveness of advertising spend, and contributing to improvement in brand health scores and in-store and online traffic trends across banners.

The timing of advertising spend has been rebalanced to a more, Always on Model to support bridal throughout the year. We also launched our holiday marketing in the third quarter this year to showcase new product and drive customer awareness earlier in the holiday season.

This holiday, each of our banners has innovative, integrated campaigns with improved scores versus last year, and nearly all new ads in the top quartile, in external database testing. These plans reflect our strategy to shift more spend to digital and mobile, with significant increases in digital video.

We're in New York City this week, launching breakthrough of that marketing with NBC's tree lighting special, at Rockefeller Center, leveraging our Center of Me diamond jewelry and filming Kay's sponsorship of the Empire State Building signature Holiday Light show, which airs later this month.

Both are iconic pop culture moments that resonates with our customers' heartfelt sentiment at this time of year, creating attention grabbing, multi-channel activations that drive cultural brand relevance for Kay.

These events are just examples of the many activations we've added to help drive impressions across earned, social and digital increasing consumer engagement and providing additional opportunities, to share our new creative.

Investments we made in our customer data platform and data analytics, combined with the capabilities of our new media agency are enabling us to deliver significantly more targeted digital content. And higher total impressions at a lower cost.

Now, I would like to discuss our plans to leverage our full-service jeweler capabilities. Growing the services business is an important part of our long-term strategy, as it creates more opportunities for us to interact with customers and create loyalty, while also driving incremental revenue and margin mix.

As I mentioned on our last call, we believe piercing is an opportunity to increase traffic and build customer relationships early in their life cycle of jewelry purchases. Leveraging the expertise of our Piercing Pagoda team, we performed successful tests at a group of Kay stores earlier this year and launched piercing services in more than 400 Kay stores in the fourth quarter.

We have implemented email, social and in-store marketing to drive awareness of our new piercing offering. Early customer feedback has been positive. And we expect piercing to become more meaningful over time, as we further scale our efforts.

In repair, we have seen steady improvements in our Net Promoter Score this fiscal year. We've added special events, marketing support and website updates to drive customer awareness of our enhanced repair services offering. For example, this weekend, Kay, Zales and Jared are hosting Get Your Sparkle On in-store events with free cleanings to prepare customers jewelry for the holidays, along with a 10% off any care and repair purchase during this event, driving an additional touch-point with our customers.

Overall, we've built new services capabilities, which we expect to drive customer acquisition, increase frequency and grow customer loyalty. While the contribution from services will be small in fiscal 2020, we expect it to be more meaningful revenue and margin contributor in the long-term.

Turning to OmniChannel, we've made significant investments in OmniChannel for holiday across our stores and websites. In stores, we now have over 19,000 iPads in place and have upgraded bandwidth across our store base. This enables every jewelry consultant to service our customers with virtual inventory and inspiring custom-designed selling tools.

In eCommerce, we successfully transitioned the Kay and Jared websites to the hybris platform during the third quarter. This common best-in-class technology foundation enables greater speed and efficiency with all banners delivering faster website load speeds.

We've also made important investments in mobile this year, including a recent launch of mobile-first capability, allowing customers to design your own jewelry, as well as investments in higher quality images and curated search. We believe these investments set us up to drive higher traffic to our sites and create a more compelling user-friendly experience.

Moving on to Culture of Agility and Efficiency, our cost optimization efforts continue to positively impact our results. We expect \$70 million to \$80 million in net cost savings in fiscal 2020. Our full year gross savings are primarily driven by indirect procurement, workforce optimization and lower corporate costs. Other efficiencies in direct procurement and distribution began to impact our results in the second half and are expected to have additional benefits in fiscal 2021.

A portion of the fiscal 2020 gross savings are reinvested in technology and innovation initiatives to drive growth. 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. These cost savings have and we believe will continue to enable us to fund investments, mitigate headwinds and improve our profitability over time.

Before I turn the call over to Joan, I will briefly discuss our fourth quarter and fiscal 2020 financial guidance. Our fourth quarter guidance for same-store sales decline of 2% to 4% is consistent with the fourth quarter outlook embedded in our previous annual sales guidance. Black Friday weekend sales performance was in line with our expectations, with particular strength on Cyber Monday, both in-store and online.

Overall, our fourth quarter sales outlook balances our optimism about the strength of our holiday merchandising, marketing and OmniChannel initiatives with a competitive US retail environment, potential negative impacts from a shorter US holiday selling season and a continued difficult UK operating environment. As a reminder, we have many key selling days still to come as December is the largest sales month in our fiscal year.

We are raising fiscal 2020 same-store sales guidance and the lower end of our non-GAAP operating profit guidance range to reflect year-to-date over delivery. We continue to expect fiscal 2020 adjusted free cash flow to be higher versus fiscal 2019, primarily driven by disciplined inventory management.

In closing, we are encouraged by the progress to date on our Path to Brilliance transformation journey as we continue to execute with diligence, while operating in a dynamic and competitive retail environment.

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. In my remarks, I'll first cover the highlights of our third quarter financial results, briefly discuss the results of our recent refinancing, and then conclude with guidance.

In the third quarter, total same-store sales grew 2.1%, with brick-and-mortar same-store sales up 0.9% and eCommerce sales up 11.4%. In North America, same-store sales grew 2.9%, with brick-and-mortar same-store sales up 1.6% and eCommerce sales up 13%. Kay and Jared's same-store sales performance benefited from additional clearance to accelerate inventory reduction ahead of new merchandise for holiday.

North America eCommerce reflected improvements at James Allen, as well as strong performance from our core banner. North America eCommerce sales excluding James Allen were up 10.6% in the quarter, inclusive of a planned technology platform change at Kay and Jared.

International same-store sales declined 5.2% and continue to reflect the challenging operating environment in the UK. Revenue declined 0.3%, reflecting same-store sales growth, the impact of net store closures and the impact of foreign exchange.

Non-GAAP gross margin was flat to prior year with procurement-related transformation cost savings and higher credit revenue share payments offsetting a lower merchandise margin.

The lower merchandise margin in the third quarter included the impact of Kay and Jared inventory reduction efforts. Additionally, the positive brick-and-mortar same-store sales performance resulted in leverage of our store occupancy costs.

SG&A was down \$12 million or 0.9% of sales on a year-over-year basis. This performance was driven by lower corporate and indirect spend, as well as lower store staff costs, primarily due to store closures, partially offset by a \$12 million increase in advertising.

Non-GAAP operating loss improved year-over-year, reflecting the benefits of cost saving and a lower net impact of credit, somewhat offset by higher levels of clearance to accelerate inventory reduction and an increase in advertising.

Interest expense was \$2 million lower year-over-year due to lower average borrowings, lower average interest rates, post the debt refinancing during the quarter and higher interest income on cash balances.

The non-GAAP EPS loss of \$0.76 was an improvement versus prior year inclusive of a smaller operating loss and lower interest expense. Overall, third quarter non-GAAP EPS was ahead of our guidance due to better sales performance, strong cost discipline and lower interest expense.

Turning to balance sheet and cash flow, inventory is down 5% versus the prior year in the third quarter, as we continue to thoughtfully reduce legacy inventory and employ a more disciplined purchasing strategy for new merchandise. We generated \$80 million in adjusted free cash flow year-to-date, up \$243 million year-over-year as a result of solid progress on working capital.

Before moving on to guidance, I would like to briefly discuss our previously announced refinancing transaction, which was completed during the quarter. We entered into new five-year asset-based credit facilities with availability of \$1.6 billion, which replaced the previous revolving credit facility and term loan facility due in 2021, and funded a tender offer for a majority of outstanding senior notes due in 2024.

The refinancing improved our financial flexibility by extending Signet's debt maturity profile, increasing available liquidity and slightly lowering interest expense, while having a neutral impact on leverage. We continue to expect our leverage ratio to be approximately 4 times by the completion of our transformation plan at year-end fiscal 2021.

Turning to guidance, for the fourth quarter, we expect same-store sales of down 2% to down 4%. Non-GAAP operating income is expected to be \$222 million to \$232 million, with a non-GAAP EPS range of \$3.01 to \$3.16. Our fourth quarter sales outlook incorporates optimism in our plans for holiday, balanced with a competitive US retail environment, as well as a challenging consumer environment in the UK.

Our operating profit guidance range includes some flexibility for a promotional holiday, somewhat offset by cost savings. Our fiscal 2020 same-store sales guidance is now 1% to down 1.7% (sic) [down 1.7% to down 1%], with non-GAAP operating profit of \$270 million to \$280 million.

Our sales update reflects the outperformance in the third quarter and holds our prior fourth quarter sales guidance. We are raising the low end of the non-GAAP operating profit guidance based on year-to-date performance, while holding the upper end of the range to provide flexibility in the always competitive holiday season.

This guidance reflects a modestly positive year-over-year net impact of our outsourced credit model. Our guidance also includes the List 4 tariff, which we do not expect to be material to fiscal 2020 results. At the end of fiscal 2020, we now expect our exposure to Chinese goods to be a low-teens percentage of our merchandise spend versus our previous guidance of mid-teens.

Our non-GAAP EPS guidance reflect our updated operating profit range as well as lower interest expense expectation post our refinancing and a slightly lower tax rate. We continue to expect inventory levels to be lower at year-end versus 2019 and adjusted free cash flow is expected to be above fiscal 2019 level.

To close out my comments, we are intensely focused on delivering our operational and financial commitments for holiday. I'm confident that we're on the right path to continue reducing costs to fund our transformation growth priorities, while optimizing working capital to enable higher free cash flow.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Paul Lejuez with Citigroup. Paul, your line is open.

Paul Lejuez

Analyst, Citigroup Global Markets, Inc.

Q

Hey. Thanks, guys. I just wanted to circle back on your Black Friday comments. You said it was in line with expectations. Does that mean specifically that it was within that down 2% to 4% that you were looking for the fourth quarter?

And then second, you mentioned that Kay and Jared were driven by clearance. Can you quantify how much that did impact your third quarter comps? And I wasn't quite sure I understood the comments about how the clearance activity did not impact merchandise margin or wasn't included in your comments that merchandise margins were flat. Maybe if you could just expand on that a little bit? Thanks.

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

A

So, thanks Paul. The comps for the quarter, we – the mention was about clearance for Kay and Jared. And Kay and Jared did have higher clearance sales, clearance level of selling and it really drove their comp. However underneath that, we are pleased with the performance of new product.

I would say also that the Zales and Pagoda businesses were largely driven by irregular price promotional type comps and had normal penetration of clearance activity. Gross merchandise margins on a non-GAAP basis were relatively flat. And as we look at the merchandise margins, it was lower because of the clearance selling itself.

With respect to Black Friday that is incorporated into our view of guidance, but we're not giving guidance specifically or giving actual results relative to the Black Friday performance.

Paul Lejuez

Analyst, Citigroup Global Markets, Inc.

Q

Okay. Maybe just one follow-up. Can you talk about sales recapture from stores that are closing? Maybe how much that could have helped comps this quarter, even this year? And what are your typical recapture rates as you look historically?

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

A

The transference rate is 30% is what we target for our store closures.

Paul Lejuez

Analyst, Citigroup Global Markets, Inc.

Q

And is that what you're seeing currently?

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

A

We see that broadly in some of the older stores, the regional stores and it differs by banner Paul, but we're finding our closing strategy to be effective, but that is our target for our closures.

We've also engaged in additional activities that help us drive our clienteling and our customers to other locations, which we've incorporated that into this year's selling or sales transference and store closings.

Paul Lejuez

Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thank you. Good luck.

Operator: [Operator Instructions] There are no further questions at this time. Ladies and gentlemen, this concludes today's conference call. On behalf of Signet Jewelers, we thank you for participating. You may now disconnect.

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