Signet Group plc

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Sreedhar Mahamkali: Good morning, and welcome to the presentation of Signet. My name is Sreedhar Mahamkal. I'm from Goldman Sachs in Europe. I cover European food retailers. And Signet, for those who are not very familiar, it's the world's largest specialty retailer operating in the US and UK. And thanks very much to Terry and Walker representing Signet here today.

Terry has been CEO since 2000, and until January 2006 was also CEO of the Group's HS division. And Walker has been Group's Finance Director since 1995, and he was Finance Director for the Group's UK division from 1992. And we'll have a preliminary presentation, a brief presentation, and then we'll move on to Q&A. Thanks very much.

Terry Burman: Welcome, everybody. Thanks for attending the presentation. I'll present an overview of the business and then we'll be pleased to take any questions that you may have. We encourage you to read the risk and other factors and cautionary language in the annual report on Form 20-F, that was filed with the SEC in May of 2008. We also draw your attention to the net two slides, if you can read those that fast. Good job.

Signet is the world's largest specialty retailer jeweler with the number one position in both the US and the UK. The US accounts for about 75% of our sales and operating profit. The US jewelry and watch market is about a $65 billion market, and we have a market share of just over 4%. The market is very fragmented.

Kay is the number one brand in the market with sales of about $1.5 billion, and some 900 stores. It targets the middle mass market with typical customers having a household income between $35,000 and $100,000. Kay is 40% larger than the number two jewelry brand in the US, and that's specialty jewelry brand.

Jared is the leader in the upper middle market. It's an off-mall category killer concept. It's number four brand in the marketplace, having grown from nothing -- zero, over the last 15 years. Jared has sales of about $750 million, just over 150 stores. Typical customer has an average household income between $50,000 and $150,000. It's our fastest growing concept for the Group.

The UK accounts for the other 25% of sales and operating profit. The market size is about $8 billion to $9 billion, and per capita spend on jewelry in the UK is about half that of the US. We have a market share of 12% in the UK, and are larger than the next five specialty jewelers combined. As in the US, the market is very fragmented. Can you hear me, or is that just coming through as total static?

Okay. H. Samuel is the number one brand. It's targeted at the middle market customer and sales of about $500 million, about 350 stores. I'm going to be competing here.

Unidentified Participant: (Inaudible)

Terry Burman: That's me that I'm competing with. H. Samuel, as I said, is the number one brand. Customers -- thank you, whoever said that -- Customers have a household income between $30,000 and $80,000.

Ernest Jones, the number two brand that's focused on the upper middle market segment. So, some brands that would distinguish Ernest Jones, Rolex, Breitling watches, TAG Heuer, Omega. We have sales of about $450 million in about 200 stores. Customers have an average household income of $60,000 to $100,000. This format has the highest productivity per square foot of any of the group brands.

We have significant operational strengths in the basic retail disciplines of store operations, merchandising, marketing and real estate. For example, customer service is the most important point of differentiation. We have more externally qualified staff than any other jeweler.

In the US, all of our store managers have to be qualified diamontologists, and they get that degree from the Diamond Council of America, a third-party education organization.

In the middle market we have the leading merchandising systems and sophisticated supply chain practices. In the US , where 75% of our merchandise sales are diamonds, we buy about 50% of the diamonds loose on the international markets, and manufacture jewelry under contract. We're also growing our capability to source rough diamonds.

We spend nearly twice the industry average as a percent of sales on advertising and marketing in the US. We have two of the three specialty retail jewelry brands that have sufficient scale to advertise on national network television, which has proven to be the most effective channel of products such as jewelry, with a high emotional content.

We're very disciplined in our investment as a result of our well located store base.

Specialty retail, like every retail business, is subject to the economic cycle. Therefore, in good times we have built a strong balance sheet, quality assets, and leading operating standards. When the rough times came, we have been able to remain on strategy while appropriately adjusting our execution for market conditions.

Sorry, I forgot to change that slide earlier. This slide shows our performance on an industry context. Our competitive strengths are reflected in our well above industry average financial metrics in both the US and the UK.

Yesterday, we announced our results for the first six months of the current year and these reflected the very challenging consumer environment. In the first half, Group total sales were flat and comp store sales were down 3.4%. Although the operating profit was down in this environment, unlike many of our competitors, we remained meaningfully profitable with a margin of 5.7% in the first half.

With about 40% of our sales in the fourth quarter, the results will, as always, be significantly influenced by our performance during the important Christmas season.

As a result of our strong balance sheet and our ability to stay on strategy through challenging times, we believe we'll be well positioned when the consumer recovers, having strengthened our competitive position in the current marketplace.

Another development with the Company. On August 19, our shareholders overwhelming approved proposals to facilitate the move of our primary listing to the New York Stock Exchange. Our rationale is that US-based investors are more familiar with our business in the retail marketplace in which we operate 75% of our business here in the US.

The US investors better understand the US economic environment. We'll have lower foreign exchange exposure, and we'll have a more appropriate peer group of specialty retailers by which to value Signet.

The domicile of the holding company will move to Bermuda. This will minimize the impact on current holders that are international investors, and avoid the negative tax consequences of moving to the US. The move, subject to some procedural approvals, is expected to become effective in about a week -- yeah, exactly a week, on September 11. And this will be accompanied by a secondary listing in London.

So, that concludes my opening remarks. So, I just start with questions?

Sreedhar Mahamkali: Absolutely. We'll start with the questions I think we're asking most companies presently at the conference. In terms of macro backup in the UK and the US, what are you assuming in your business plans over the next six to 12 months? Are you assuming things are getting better, worse, same, and why?

Terry Burman: We're really focused on -- is this on? We're really focused on the environment from now to Christmas. The only decisions that we have to make right now are -- the only decisions we have to make right now are about store space growth. So, we've stressed our predicted models, and that has impacted -- negatively impacted the amount of space that we're going to expand, which is the last few years has been about 10% growth a year, net space growth.

We talk about space as opposed to number of stores, because the Jared's are four times the size of a normal mall store. So, each one counts as four.

In terms of inventory levels, store staffing, advertising, you can assume that we would figure on -- that we would -- well, I don't want to discuss our internal plans. We probably plan at about the run rate at which we're going. But we can -- planning the business is not that precise. You do 5% or more or less business, we can adjust our staffs very close in using part-timers and adding hours to full-timers. We've got shelf stocks of inventories, we've got vendors. So, we can bring in more if we have to. We've got great systems to measure that. So, we're really focused on the next four months, four or five months, and going through the fourth quarter.

Sreedhar Mahamkali: Okay. And then moving on to margins, are you expecting over the next 12 months margins in the business to stay where they are, or rise, or --

Terry Burman: Are you talking about gross margins?

Sreedhar Mahamkali: Yeah, and also operating margins, if you would.

Terry Burman: Yeah. The two factors that are going to most influence that are if we get commodity fluctuation, and the question is what's our gold buying rate going to be for the rest of the year? And I don't know the answer to that. It could be significantly dependent on the gold buying rate.

It will -- if gold stays here at this low $800 level, that will be somewhat helpful, marginally helpful to the fourth quarter. If it goes up above $900, it won't be helpful. Obviously, if it goes down further it will be even more helpful.

Mix changes can also influence -- product mix changes, and also influence our gross margin.

But to summarize all this, we said that we expect margins for the year, gross margins for the year, to be at least equal to those of the prior year. And we did take a price increase in February and March that has had encouraging results. Obviously, we're sacrificing unit sales, but we believe our gross margin dollars are ahead of where they would have been had we not taken those price increases.

Sreedhar Mahamkali: Okay. And, finally, regarding the credit crisis, has it led you to be more guarded or opportunistic when it comes to buy-backs or leverage, capital allocation, any of those areas?

Terry Burman: Well, the consumer environment is obviously has an impact on how we allocate capital. But we're sticking with our principles. We've -- as I said in the presentation, we have built a strong balance sheet. That strong balance sheet gives us the opportunity to sustain our strategy in more difficult times and in better times, this being one of the more difficult or challenging environments.

Our investment criteria remain the same, however, in terms of investing in the business. We have a 20% -- we have a criteria that any store that we're going to open is going to be 20% IRR on a five-year discounted cash flow basis.

So, if we find locations that meet this criteria, we're happy to continue to invest in them. However, we stressed our sales models, which has made it so that fewer stores achieve that criteria, and that's the factor behind reducing our space growth.

In terms of -- so, there's really no change in principle for us, but the market has changed.

Sreedhar Mahamkali: Sure. I'll just ask one more question and we'll see if there are questions from the floor. In terms of pricing, you talked about price increases you put through recently. Do you anticipate having to put through any more prices (a), and also if you can touch on the promotional activity that you plan particularly in the UK, you mentioned, basically, please.

Terry Burman: There won't be any more price increases this year. Our pricing is set for the fourth quarter now. And in terms of promotional activity, we have increased our promotional cadence and we do have promotional contingencies for the fourth quarter -- and in both the US and the UK we've increased our promotional cadence. And we do have contingent plans where we can add additional promotions in the fourth quarter in our business if the need -- if we think that the environment calls for it.

Sreedhar Mahamkali: Okay. We'll see if there are questions from the floor.

Unidentified Participant: A couple of unrelated questions. Can you talk about how much your merchandise assortment in your stores is exclusive or proprietary to you? Secondly, it looks like you should be benefiting from the maturation cycle of your Jared stores; a lot of those stores are less than five years old. How is that maturation cycle do you think will be impacted by kind of the tougher macro conditions? Do you expect to still get to the same level of sales by year five, same level of profitability but it just takes a year or two longer? Is that the right way to think about things conceptually?

Terry Burman: Right. In terms of exclusives, we have focused on differentiating ourselves with more exclusive products. So, we brought in -- we just started a range of merchandise that was designed by the actress, Jane Seymour, that's tested very well in our stores in spring, and we're going to be rolling it out to all the mall stores for the Christmas season.

We're the exclusive mall representative and we have a separate range in Jared for a jewelry designer called Le Vian, who is very well known in the jewelry industry and we've had a lot of success with that.

We've got the Leo Diamond, which is our exclusive cut, which is cut for greater fire, sparkle and brilliance. It's the first diamond ever certified for greater light reflection.

So, in terms of exclusives -- and there are other exclusive programs that we have. In terms of exclusive, I would say, including the Leo, probably amounts to about, oh, maybe 20% of our sales.

We've got another diamond in Jared called the Peerless diamond, which is an ideal cut that reflects very high on the light reflection scale. But, again, about 20% of our products with the exclusive to us.

The second question, Jared maturation. I think what will happen is the stores will get to the same level but it's going to take a year longer. But it could take two years longer. It depends on -- I don't know what the length or the severity of the downturn is going to be.

Now, through the end of the last fiscal year, we were still meeting our investment criteria for all the Jared stores including the ones that we opened last year. We actually beat by about 20% for the stores that we opened last year. But current environment is certainly having an impact on the stores this year.

And so when I say it could take a year longer, take a year longer from where they might have otherwise been, which is a level of outperformance of our pro forma criteria.

Unidentified Participant: Two questions. How big is your watch business, and what trends have you seen in Q1 and Q2, the different price points? And the second question is, on the commercial environment along with some of your competitors, who might be liquidating stock?

Terry Burman: In terms of the watch business, it's about 7% of our sales in the US. It's more like 5% in the malls and 12 in Jared. So, it's a bigger percentage in Jared, where we have the luxury watch brands, like Rolex, TAG, Omega, Baume & Mercier.

The trends for Q1 and Q2 have been pretty similar. In the UK, the watch business is a much bigger part of our business, runs about 30% of our business.

In the middle market brands, in H. Samuel, the trends have been pretty similar to the year-to-date, Q1 ad Q2, as they have in -- as they have in Ernest Jones. Ernest Jones brands, which carry those higher-end luxury watch brands, have been gaining share of our product mix this year versus last year. So, watches have been very robust in the UK market.

The liquidation sales, and I assume you're obviously talking about the US there. We feel that in the first half that we were probably impacted by Freidman's and Zales by about 2% on our comps. So, it took some frosting off.

I think you need to remember that you see the headline about how much these companies are liquidating, but they would have sold a certain amount of merchandise anyway. So, they have to make up for those sales and then incremental above that to put pressure on the other retailers. And then it comes out of the entire marketplace, so all jewelers, in fact, other categories are having some sales diverted through the liquidation sales.

We don't see any more pressure on our comps, and maybe a little less on the fourth quarter. As Zales winds down its liquidation sales, and as Whitehall, who is now liquidating and just started, by the time they get to the fourth quarter, we would expect less of a percentage impact than we would see in the third quarter. So, put all that together, as I said, we think less of an impact.

The good news about all this is we get into January and for the next year we're not going to be facing all that at that level. We don't believe that we'll be facing that level of liquidation.

Unidentified Participant: I'd like to know about the productivity of your stores in America and the UK in terms of rent and sales per square foot.

Terry Burman: Okay. Do we have presentations out there? Okay, if you grab one of the presentations that we have out there, and they look like this. Okay, we can get you those, if you see us after the presentation. But if you look at the -- and we talk about sales per store. The average mall store being about 1500 square feet --

Unidentified Participant: Per square foot, not per store, also like-for likes.

Terry Burman: Okay. Just let me tell you how we talk about it and then we can figure out what it is per square foot. The sales per store, and the average mall store is about 1500 square feet, in our Kay division is 1.7 million a store, so that would make it about $1100 a square foot.

In our regional divisions, also about 1500 square feet, they average about 1,350,000 a store, and that's obviously about $900 a square foot. Our Jared stores at maturity average about $6.4 million a door, and those stores are about 6,000 square feet, so that's about $1100 a square foot.

So, if you can see Kay and Jared about $1100 a square foot, the regional brands about $900 a square foot. Did you have -- was there something else you were asking about that? Did you ask about same store sales productivity between (inaudible)?

Unidentified Participant: Like-to-likes, yes.

Terry Burman: Like-for-like, okay. By the way, in the UK, the sales per store in the H. Samuel division are about 1.4 million per door in dollars, and they're about -- that would be about $900 a square foot.

In Ernest Jones, the sales per store are about $2.2 million per door, and that's over $2,000 a square foot. So, as I said in my presentation, Ernest Jones is the most productive on a per-square foot basis brand that we have.

In the like-for-likes, we really don't break those down by brand in the US. But I can tell you that the Kay and the Jared brands to out-perform the regionals. The regionals are more of a drag on our like-for-likes. Our press release did outline our results in Ernest Jones and H. Samuel like-for-likes, and they're both running very similar for the first half at about a little over 2%.

Unidentified Participant: In your presentation you have a comparison slide on page 26 that talks about UK growth, and it shows I guess the five-year growth on average for per-year UK business has been less than what the industry average by a pretty significant percentage. Can you just talk about why that's the case? It looks like you haven't really been adding much in terms of square footage. Is there something different that's going on, a new competitor, or what's been going on where the market has been going faster than you have? I'm looking at sales growth, the five-year period, Signet 0.5% and typical UK specialty jewelers 3.5.

Terry Burman: Right. If you flip ahead a couple of slides you'll see the H. Samuel Division, we've taken it from 418 stores down to 359 stores, so that's the reason. We've been -- we've reduced about 60 stores in the H. Samuel division, which has hit the total sales line. But, as you see, the average sales per store in H. Samuel over the last five years are up.

And if you flip ahead two more pages under the Ernest Jones, you see while there's been some addition of store count, sales are up -- average sales per door are up in the high single digits.

Unidentified Participant: Was there a common denominator for those H. Samuel stores that you closed? Were they getting out of malls or getting out of certain geographic regions of the UK, or --

Terry Burman: Yes, lower productivity indoors. And as we change our format to more of a jewelry format, if you notice the H. Samuel sales in diamond merchandise have gone up from -- in the five-year period they've gone up from 12% to -- I'm sorry, from 16% to 22%. So, as we shifted our emphasis more on jewelry and away from gifts, that required a remodeling of stores. And some stores just aren't -- weren't productive enough to remodel the stores and invest in them. And so we decided to rationalize the store portfolio a bit at the end of their lease term, or to sell off the stores. So, there wasn't any penalty in terms of lease charges, but we did -- we have reduced the number of stores because they just weren't productive enough in a jewelry format, as we've transitioned into selling more jewelry. So, that's the reason behind that. Does that answer your question?

Unidentified Participant: What percentage rent do you pay in the US and UK (inaudible)?

Terry Burman: UK leases usually don't have turnover rent. You mean what's our total occupancy cost as a percentage of sales?

Unidentified Participant: Yes.

Walker Boyd: The cost in the UK would be higher. As Terry said, it's predominantly fixed rent that's going to average in the 11% to 12% of sales. In the US, we have more turnover rate that's going to be in the mid -- 7% to 8% of sales.

Unidentified Participant: So, higher in the UK.

Walker Boyd: The UK has a higher occupancy cost, yes.

Unidentified Participant: And your stock cost in the two countries?

Walker Boyd: The opposite would be the case. We would have typically a higher stock cost in the US than in the UK as a percent of sales.

Unidentified Participant: What percent?

Walker Boyd: That's proprietary.

Sreedhar Mahamkali: If you could talk a little bit about the credit book, please, and the increase in the bad debt charges. Does that concern you? Are you planning to make any changes to the approval process and lending strategies?

Walker Boyd: In terms of the fundamental approval process, no. I think we have seen and we believe our score cards work. We have seen as the consumer personal balance sheet deteriorates, we have seen a reduction in our approval rate. And certainly in terms of our credit analysts, who look for trends in terms of groups of customers who are showing a higher bad debt risk than would be justified by the gross margin dollars, then we're going to tone down approval in these specific attributes.

Very similar, I think, to the real estate. We will keep the bar at the same height, and just as we stretch our sales models to new stores, then as consumer personal balance sheet deteriorates, then fewer people are going to clear the hurdle, and therefore we have seen a reduction somewhere in the region of 250 basis points in terms of our approval rate. So, it becomes self-regulating in that sense.

Our basic credit offer and our lending strategies have been consistent now for well over the last decade. I think in terms of the loss rates, clearly they are of a concern, alongside any other issues going up.

And one thing we have done as part of our analysis book in the first six months is had a third-party consultant come in and their conclusion was that the performance of our portfolio is very similar to what they've seen in other portfolios. And therefore concluding that the issues in respect of increase in the loss rates were driven by the general economic environment rather than anything Signet were doing.

The only other comment I would make is that in terms of P&L and the impact on the overall credit book, to some extent the loss rate have been offset by a higher interest that we are receiving from the portfolio as consumers pay off the debt in slightly longer term.

In that sense, we are still relatively short-term consumer finance, but the debt that the portfolio now tunneling about 7.5 months as opposed to 7 months in the prior year. And therefore we do get meaningful offset in terms of interest from that portfolio to the increased loss charges.

Sreedhar Mahamkali: Can you perhaps talk about rate of delinquency and trends there? And also approval rates, what are the approval rates and what's the trend to be noted?

Walker Boyd: Well, as I said, our approval rates are down in terms of about 250 basis points. I think in terms of the trend, because of the way we provide for bad debts and we provide in a very nonsubjective way we will provide 100% for any consumer who is 90 days past due on a (inaudible) basis.

So, the trends that we report on a quarterly basis are fairly up-to-date. And, as I say, there is no subjective, and the way we provision it is a very mechanical exercise. So, I think the trend that we announced yesterday in our interim is the current trend.

Sreedhar Mahamkali: Just take one maybe from the floor?

Unidentified Participant: Can you talk a little bit about warranty sales, how important they are to you? What your policy is and what they might represent in terms of overall earnings?

Terry Burman: Well, we've had the same warranty program. We've had a lifetime warranty program since 1995.

Walker Boyd: In terms of sales, they would be meaningfully less than 10%, in the mid-single digits. That is a US number. UK would be slightly lower.

Terry Burman: And what else did you want to know about them?

Unidentified Participant: How about in terms of profitability?

Terry Burman: Well, we're not going to talk about our gross margins on any specific product, but certainly it's a profitable exercise for us.

Unidentified Participant: And no change to your program or strategy there?

Terry Burman: No. As I said, we've had the same program in place. It works well. We execute it, our field executes it well. I wish I could say we were flattered by imitation, but we've had the same program in place since 1995.

Unidentified Participant: (Inaudible)

Terry Burman: Strong. You know, you can see from our numbers that we execute quite well, and you can assume that our attachment rate, the performance of our attachment rate is probably stronger than our competitors, just like the rest of our numbers are.

Sreedhar Mahamkali: One last question, perhaps?

Unidentified Participant: (Inaudible)

Terry Burman: If you talk to Tim, he can give you specific details, but I'll give you -- I'll just guesstimate some numbers and I would say about 4500 square feet of it is selling space. I'd say about -- what's the shop, maybe 400 square feet. The shop is about 400 or 500 square feet. And the -- and obviously it's a self-contained building, so you've got to have more -- about 1,000 square feet is back office, restrooms, and eating area for the employees, which you don't have to have in a mall store. So, you get a little bit of -- extra space has to be allocated to support functions.

Unidentified Participant: (Inaudible)

Terry Burman: Yes. We do 100% of our repair work. Sometimes we've got emergencies, so we might have some local jewelers do it, but very close to 100% of our repair work is done by our own department, our own employees in our repair centers across the country. And all the

Jared shops, all the Jared stores have repair shops. They're all our employees, no contract employees. We control the quality and we control the customer service of our repair business, and we consolidate all of our repairs into all of our Jared shops.

So, all of the Kay and all of the regional brands feed into all of the Jared shops and makes those shops more productive. So, we can have anyplace between four and eight jewelers in any one of those Jared stores.

And, as I said, it gives us a competitive advantage. Repairs on the spot, we control the quality, we control the customer service. And customer service, hugely important issue in terms of repairs, because customers are turning their jewelry over to you, and they don't like to part with it. So, you need to give them a good experience.

Sreedhar Mahamkali: That's the last question. We've run over our time. Thank you very much. We really appreciate it.

Terry Burman: Thanks.