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Conference Call Transcript

SIG - Preliminary 2005/06 Signet Group Earnings Conference Call

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PRESENTATION

Terry Burman - ***Signet Group - CEO***

Good afternoon. I am pleased to welcome all of you in the room and those joining us by webcast and conference call. I'm Terry Burman, Group Chief Executive. With me is Walker Boyd, our Group Finance Director, and sitting in the front row is Rob Anderson, UK Jewelry CEO, and Mark Light, Chief Executive of our U.S. division.

I will present an overview of the business, and Walker will then summarize our financial results and the implications of our growth plans and afterwards we will be happy to take any of your questions.

As we have U.S. investors attending, I will ask Walker to give the Safe Harbor statement.

Walker Boyd - ***Signet Group - Group Finance Director***

This preliminary results presentation includes certain statements which are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based upon management's beliefs, as well as on assumptions made by and data currently available to management and appear in a number of places throughout this presentation. They include statements regarding among other things our results of operation, financial condition, liquidity, prospects, growth, strategies and the industry in which the Company operates. These forward-looking statements are not guarantees of future performance and are subject to a number of risks and uncertainties which are more fully

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described on slide two of this preliminary results presentation and in the risk and other factors section of the Company's 2004/5 annual report on Form 20-F filed with the U.S. Securities & Exchange Commission on May 3, 2005 and other filings made by the Company with the Commission.

Actual results may differ materially from those anticipated in such forward-looking statements, even if experience of future changes makes it clear that any projected results expressed or implied therein may not be realized. The Company undertakes no obligation to update or revise any forward-looking statements to reflect subsequent events or circumstances.

Additionally certain financial information used during this presentation are considered to be non-GAAP financial measures. For a reconciliation of these to the most directly comparable GAAP financial measures, please refer to slides 49 and 50 of this preliminary results presentation or to the Company's earnings release dated 5th of April 2006 available on the financial information section of the Company's website at www.signetgroupplc.com.

Terry Burman - *Signet Group - CEO*

Thanks, Walker. Our superior growth supported by our strong balance sheet leverages and reinforces our long-term competitive advantages. We focus on building shareholder value through increasing profits over the medium and long-term. During 2005 we became the number one specialty jewelry retailer in the U.S. With sales of almost $1.3 billion, Kay further advanced its position as the number one jewelry brand. This has been achieved by consistent organic growth.

Similarly Jared has been built into a top five retail jewelry brand and is fast approaching critical mass with a store contribution rate nearing that of the U.S. division as a whole. We plan to increase new store space by 8 to 10% per annum with an investment of some $1 billion over the next five years. The UK division, despite the difficult retail environment in 2005, still achieved healthy operating margins, return on capital employed and cash flow. The business offers potential for further improvements in operational execution to drive sales and profitability. In both the U.S. and the UK, the jewelry market offers superior long-term growth as GDP increases.

Looking at our fiscal 2006 results, sales approached 1.8 billion pounds, up 8.5% in total and 2.4% on a like-for-like basis. Profit before tax was just over 200 million pounds, slightly ahead of expectations reflecting good trading in January and tight control of inventory and receivables. Earnings per share were 7.5p, and the board is pleased to recommend that the final dividend is increased by 10%, giving a full-year dividend of 3.3 pence.

The increase in group like-for-like sales continued our consistent growth record and demonstrated the benefit of operating in two geographic regions. The U.S. division's increase of 7.1% was above the five-year average and comfortably ahead of the U.S. retail sector in general. In the UK retail trading conditions remained difficult throughout the year, and like-for-like sales declined by 8.2%. The five-year compound annual growth rate is 2.8%.

These four graphs demonstrate our five-year record. For fiscal 2006, group operating margin was in the middle of our 11 to 13% range. Earnings per share of 7.5p were down 4% on a reported basis and 6% using constant exchange rates. The five-year compound annual growth in earnings has been about 5% on a reported basis and 8% using constant exchange rates. Return on capital employed was down, reflecting the sharp fall in UK profitability and the impact of consistent new space growth in the U.S. but still remained comfortably above 20%.

Turning to the U.S. division, both total sales and like-for-like sales growth were comfortably ahead of their five-year averages. Operating profit was up 13.6% to just over $300 million. Operating margin was similar to last year, the leverage from the like-for-like sales growth offsetting the decline in gross margin and the increase in immature store space. Return on capital employed remained at the upper end of the range of the past five years, despite the incremental rate of new space growth.

Looking at the wider U.S. market, growth in retail sales was slightly lower than in 2004 but remained reasonably buoyant. Jewelry sales growth slowed a little more than average, reflecting consumer purchases of digital music players and other electronic products. The U.S. division continued to outperform and in 2005 increased the differential over the sector and other categories shown.

As I said earlier, Signet has become the largest retail specialty jeweler in the U.S. with sales of $2.3 billion. Our objective has been to continually improve our business and to achieve industry-leading operating standards which have led our consistent record of outperformance, driven by like-for-like sales and space growth. We increased our market share by 70 basis points to 8.2% last year, while Zale Corp. declined slightly. These figures are based on U.S. government statistics that were revised during 2005. The revision restated back to 1998 and reduced the growth in the

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specialty sector from 4.7 to 4.2% per annum. The revised data also shows the specialty sector accounting for a little over 48% of the total jewelry market over the last five years and 47.3% in 2005.

As a result, Signet and Zale's specialty market share has been restated upwards.

Our superior sales growth creates a virtuous cycle. It reinforces our competitive advantages, for example, leveraging marketing expenditure, store cost and home office support and helps drive supply chain efficiency. This leads to higher store productivity and increased profit, which can be reinvested in carefully tested initiatives and new stores, resulting in further superior growth.

These charts show leverage at work. Sales from mall stores have risen to over $1.6 million. Support staff productivity has risen by nearly 10%, including increased central capacity put in place over the last 18 months to support the faster rate of store openings. Gross marketing expenditure has increased by nearly 12% per annum, while increasing only 40 basis points as a percent of sales due to the higher mix and advertising cost of Jared. This increase in spend, together with a greater emphasis on broadcast media, means we gain leverage across the store base from additional impressions, particularly Kay.

All of these factors help lift operating profit.

Looking now at our growth plans, our first priority remains driving the productivity of our existing store base. This is fundamental to increasing profits and providing the resources to help fund new space growth. Our focus will remain narrow and deep by expanding our existing formats, and we will maintain strict operational and financial investment criteria.

Over the next five years, we plan a 40% increase in store numbers. This will require an investment program of approximately $1 billion.

Looking at each of the store formats in turn, Kay had 781 stores at the end of fiscal 2006. Its sales increased by 10% to almost $1.3 billion, and Kay's position as the number one specialty jewelry brand was significantly strengthened during the year. We plan to open a further 300 net new stores over the next five years, investing some $350 million. Around 60 Kays are planned to be opened in the current year, including 30 to 35 in covered malls, which will be offset by about 10 closures. The 31 off-mall locations being tested continue to meet their sales pro-formas, and we will, therefore, increase the rate of store openings to between 20 and 25. A further two Metropolitan stores are planned.

There is currently one Kay store in an outlet center, and up to five more will be tested this year. We see the opportunity for between 50 and 100 such units. They will be run within our existing business structure using the same merchandising and store operations team with marketing support from the national advertising campaign. In total we see the potential for over 1,450 Kay stores. A major benefit of this space growth will be to further increase the marketing budget, driving name recognition and purchase intent across the entire Kay division.

I would now like to show you a Kay TV advertisement broadcast last Christmas, helping us achieve our superior sales growth.

(Shows video). (technical difficulty)--. I would like to move on, but the slides are not ready. This is --. Well, this is Santa Claus. He is our mall Claus. He buys a ring for Mrs. Claus, heads up to the North Pole, hands Mrs. Claus the ring, and as you would guess, "Every Kiss Begins with Kay" because Ms. Claus appreciates it. And then she's says to him, looking at the ring, oh, Chris, how did you know? He goes, like I'm Santa Claus; it's my job to know these things.

That is -- sorry I had to narrate it for you. But that is -- and I'm prejudiced -- that is actually the highest testing commercial that we have ever had because you are driving brand name recognition, purchase intent and likeability for our brand. And we continue to identify opportunities to further leverage the campaign as our advertising budget increases.

Our regional brands consistent of 330 stores trading under well-established local names. Sales for fiscal 2006 were up 3% to almost $500 million. These stores have the same merchandising staff training, real estate and marketing spend to sales ratios as Kay. However Kay has consistently outperformed them over the last five years by about 5% per annum on a like-for-like basis. The difference reflects the use of national television advertising by Kay, while the regionals use local radio, direct marketing and catalogs. Therefore, we tested local TV advertising in a single market for one of the brands over Christmas 2005 and will add two further markets this year. We plan to increase the number of stores by around a third over the next five years, investing some $125 million. Between 20 and 25 stores are planned to be opened in the current year with up to 10 closures. Growth could be accelerated through acquisitions, should targets that meet our strict criteria become available.

Overall there's potential for about 700 mall stores under a second national brand.

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Jared sales rose by 29% to more than $530 million, and over the last 10 years, it has grown to become a top five jewelry brand in the U.S. jewelry sector. Its growth has enabled us to leverage the U.S. divisional overhead, and the average store contribution rate for Jared is nearing that of the U.S. division as a whole. Real estate developers were originally cautious about Jared, but now with an established successful track record, they regard it as a desirable tenant, making it easier to obtain sites that meet our very strict criteria.

The next major milestone will be the move to national TV advertising, which is expected for Christmas 2007. Over time this will leverage the increases in advertising across all the Jared stores and make it easier to enter the largest and most expensive markets.

The stores continue to meet the sales pro-formas required to satisfy our investment criteria. We are also seeing above average growth beyond the assumed five-year maturity. We believe that this is due to a combination of Jared taking longer to reach maturity than the mall stores, the luxury watch initiative driving sales and footfall, and the introduction of TV advertising. While Jared is reaching critical mass, it remains an immature concept. Around 60% of the stores are less than five-years-old, and over 90% are less than eight-years-old. This is reflected in the customer base where the average household income of a Jared customer has increased according to our latest research from $86,000 in 2003 to $92,000 this year, while the mall customer is little changed at about $65,000. We plan to double the number of stores over the next five years, investing some $500 million in the Jared concept.

Between 18 and 23 new stores are planned for the current year. In total we see the potential for over 250 Jared stores in the U.S.

As I said earlier, our first objective is to continue improving our core business in the fundamental retail disciplines of merchandising, store operations and marketing. We will not overstretch for growth and harm the existing store base. In particular, it is crucial to maintain the quality of store staff and to invest in appropriate central support functions.

We also maintain a strict investment hurdle rate for new stores. This is a 20% pretax internal rate of return over five years, well in excess of our cost of capital.

Now looking at some of the improvements that we plan to implement in the coming year, in merchandising we continue to respond to customers' increasing demand for larger and more expensive diamonds, and we will further expand the range that we carry. As part of this, we are planning to test about 15 mall superstores that draw on our experience of developing Jared and our metropolitan store concept. They will be approximately one and a half to two times the size of our average mall store and located in the most productive locations. They will have an increased diamond range, the virtual diamond vault, an in-store jewelry repair workshop and an enhanced watch collection. As well as developing Jared's diamond range, the luxury watch collection will be further extended.

A customer satisfaction index covering 20 criteria has been introduced. Each store is benchmarked against others in its district, region and across the division based on customer feedback. The scores are reported on a monthly basis, highlighting areas of good performance and those for improvement. Offering customers an excellent repair service builds confidence, and a multiyear project is underway to improve our monitoring and execution in this area.

In TV advertising, Kay will again increase spending, and Jared will take another step closer to achieving the scale needed for national TV advertising. As a customer service enhancement, we also plan to launch an e-commerce capability on a new Kay website in the second half.

The supply chain will see further measures to improve its efficiency, and our expertise remains a major competitive advantage. We are developing the capability to directly source rough diamonds, which are then cut and polished on a contract basis in state-of-the-art manufacturing units. In line with our "test before we invest" philosophy, this will be done on a measured basis over time.

And turning to the benefits that we aim to achieve, our prime objective is to secure additional reliable and consistent supplies of diamonds for our customers. This is important given our pace of growth and the expectation that the worldwide demand for diamonds will continue to grow faster than supply. We will also gain a better understanding of the supply dynamics into the polished diamond market, so improving our ability to purchase polished stones effectively.

We may also achieve a reduction in cost, but the extent of this is one of the factors we're testing. As a result of buying rough diamonds, we will hold that element of our inventory for around 60 days longer.

The key to our performance is profit growth and maintaining strict return on investment criteria. We have heard concerns about falling transaction volumes in our core stores and the decline in gross margin.

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While we monitor these key performance indicators closely, they are not the sole drivers of our profitability, rather they are elements that combine to drive total dollar gross margin per store. For example, we achieve a higher gross margin by selling a 1 karat -- sorry, a higher dollar gross margin or gross profit by selling a 1 karat Leo solitaire ring than by selling 30 gold rope chains, although the number of transactions and the gross margin percentage on the 1 karat Leo is lower.

By driving the dollar gross margin at store level, we increased store productivity, improve leverage of costs and achieve industry-leading operating ratios. Over the last three years, Signet's US gross margin is down 100 basis points, primarily due to mix changes with sales of larger, higher priced diamonds and the development of Jared, which has lower gross margins matched by lower operating costs. Both have been important contributors to our strong like-for-like sales growth.

Over the same three years, we have seen an increase in operating margin of about 100 basis points to 13% and operating profit has increased by nearly 50% to $300 million, a compound annual increase of 13%.

In the year-to-date, U.S. like-for-like sales have increased at a similar rate to that achieved in the year to 28 January of 2006. However, you should note that when we report our first-quarter sales, a marketing event ahead of Mother's Day, will move into the second quarter in 2006. This is due to the change in the date of Mother's Day in the U.S. Obviously this dislocation will have reversed by the second half. Gross margin eased reflecting the expansion of Jared, product mix changes and higher commodity costs.

Turning to space growth, we are on plan to achieve an 8 to 10% increase this year.

Now looking at the UK division. In fiscal 2006 UK sales declined by 7.5% and like-for-like sales by 8.2%. This reflected the sharpest deterioration in the UK retail trading environment in 14 years. Our UK business is more sensitive to these sorts of trading conditions than our U.S. division as between 15 to 20% of its sales are in the more stable bridal and engagement category compared to about 45% in the U.S.

In addition, the UK business has higher operational leverage than in the U.S. as sales related rent and salary costs are a smaller portion of total costs. Against the background of difficult trading conditions, pricing discipline was maintained, and gross margin was slightly ahead of last year. Although overall UK operating profits declined to 49 million pounds, the business continues to achieve a healthy operating margin of 10.5% and a return on capital employed of 26.6%.

Looking at the UK jewelry market, based on anecdotal evidence, we believe that the UK division at least maintained its market share. First, in the UK, each piece of gold jewelry must carry an Assay Office hallmark attesting to its purity, and stamping volume was down 17% in 2005.

Argos, the second largest retailer of jewelry in the UK, stated that jewelry was its worst performing category. Half Price Jewellers, one of the top 10 in the sector, was placed in administration in January 2006. Abbeycrest, a UK quoted jewelry manufacturer with which we do little business, significantly downgraded their sales expectation during 2005. And finally, our suppliers have indicated that we have outperformed our competitors.

So overall we believe that 2005 saw a realignment after the strong growth in jewelry sales over the last five years rather than a beginning of a shift away from jewelry purchases. Looking at the longer-term, our like-for-like sales over the last years have increased by 16%, while the British Retail Consortium non-food category has increased by 13%.

Our strategy of increasing diamond sales continues to be successful with penetration increasing to 29% for the division as a whole. This compares to a figure of 20% in fiscal 2000. Average transaction value was up again, although sales per store were down reflecting the lower footfall common to the retail sector.

After the challenges of fiscal 2006, it is worth reviewing progress in our UK business. We believe that performance was primarily held back by jewelry market factors rather than by internal issues. Signet’s UK division is the clear leader in a sector that is expected to show long-term growth. Our strategy has increased differentiation from general retailers that are threatening other specialty sectors. Furthermore, even in a very difficult year, the UK business achieved healthy operating margins, cash flow and return on capital employed. We did conduct a thorough review of the cost base, and where appropriate, it has been realigned to reflect the lower volume. Given its attractive returns, we will continue to invest in the business, particularly where we have identified opportunities for further improvement.

Starting with merchandising, the successful Leo and Forever diamond ranges will be expanded. Our selection will be sharper and more focused on faster selling SKUs, making it easier for consumers to shop. There will also be a further increase in the white precious metal assortment, which continues to be popular. In-store presentation is being improved to give greater emphasis to branding and to featured merchandise. Our

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promotions will be narrower and more targeted such as those over Valentine's Day so as to drive footfall and make more effective use of our buying power. We're improving compliance with our standard terms of business, optimizing our purchasing.

We have strengthened the service element of our training programs. We're testing the customer satisfaction index concept that has been developed, that I described earlier during the U.S. section. In marketing, the Ernest Jones website is planned to be made transactional later this year. While the creative execution for the H.Samuel and Ernest Jones TV advertisements has developed from previous years. Our primary focus is to move it further forward. The advertisements are testing okay, but we want them to test superior. We saw a lift where the Ernest Jones commercial was aired, and now we would like to show it to you. (Video Playing)

While this is an improvement on 2004, we are still working to improve the execution in both Ernest Jones and H.Samuel. Therefore we have appointed a new ad agency to work on the commercial for Christmas 2006. When we're happy with the state of execution we will include geographic coverage.

The store refit programs continues to satisfy our normal investment hurdle, and 70 stores were refitted in fiscal 2006. In line with the normal refit cycle of seven years for H.Samuel and 10 years for Ernest Jones, only about 35 stores, predominately H.Samuel, are scheduled for refit in the current year, and in 2007/08.

We remain pleased with the move to an open design with better interaction with the customer, but have identified some design improvements that we are now testing. These are photographs of the prototype enhancements at our store in Harrow. You notice the wider aisles, giving better customer flow within the store.

The in-store branding is also stronger. Merchandise groupings have been improved with clearer presentation of featured products. There are more lifestyle images to provide signposts for the customer. Together with the more focused merchandising, these should result in increased inventory productivity.

In the year-to-date the like-for-like sales decline in the nine week period reduced to low single digits against the background of a continuing difficult marketplace. Valentine's Day promotions and a stronger performance by the insurance replacement business resulted in some reduction in gross margin.

And now I would like to hand over to Walker for the financial review.

Walker Boyd *- Signet Group - Group Finance Director*

Good afternoon. 2005/6 saw a small decline in EPS to 7.5p reflected the significant fall in UK profits largely offset by good progress in the U.S. The dollar exchange rate movement was a small positive, but the tax charge edged up from 33.9% to 34.7%. The Board continues its progressive dividend policy, and recommends a 10% increase in final dividend, giving 3.3p for the full year. Dividend cover of 2.3 times remains a little above the UK retail sector average, reflecting the Group's superior investment opportunities, particularly further expansion in the U.S. Balance sheet ratios remain strong, with fixed charge cover of 2 times and gearing of 11% at year-end.

Group like-for-like sales for the year grew by 2.4%, reflecting a strong U.S. outcome that more than offset the sharp deterioration in the UK. Our new stores space in the U.S. saw non-comp sales growth of 5%, with total sales up 12.1% in dollar terms. The movement in exchange rate from 1.86 to 1.80 had a 3.7% favorable impact in sterling terms. In the UK the like-for-like decline of 8.2% reflected the jewelry sector as a whole, with both Ernest Jones and H.Samuel down by about the same amount. Space had a small positive impact in the UK, with store refits being carried out more quickly.

Reported Group pretax profits fell by 1.7%. Absent the favorable impact of exchange translation, the decline was 3.8%. On a constant exchange rate basis U.S. jewelry shows a 13.6% increase slightly ahead of sales growth. The 36% decrease in the UK reflects the impact of the high operational gearing of the division.

Group expenses increased by 1.2 million pounds as a result of increased corporate governance costs including those associated with preparation for compliance with Section 404 of Sarbanes-Oxley and property provisions that show a small increase on last year. Interest charges at constant rates show a reduction of 1.1 million, reflecting the benefit of higher rates on deposits in the first half.

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Group operating margins was 11.9%. In the U.S. the margin is similar to last year at 13%, with gross margin down 50 basis points. Expense leverage of 110 basis points from the like-for-like sales growth more than compensates for this and the adverse impact of new space. UK gross margins show a small increase, with the exchange benefit more than offsetting the increase in dollar commodity cost.

The high operational leverage of the UK business is reflected in the 5.2% adverse expense ratio movement. This was exacerbated in 2005/6 as a result of the impact of higher depreciation due to the refit programme, the rollout of store commission and the launch of the H.Samuel e-commerce capability. As Terry said earlier, a thorough review of the UK cost base has been carried out, and in 2006/7 the cost increase is expected to be in the low single digits.

Moving onto performance of our credit portfolio, the proportion of sales to the in-house credit card increased slightly to 51.1% but remained within the range of the last 10 years. Our credit offer was again largely unaltered, reflected in the consistent monthly collection rate of 14.5%. The impact of Hurricane Katrina on the bad debt charge was less than originally feared. While there was a temporary disruption, very few of the outstanding balances have been charged to profit, even though we have applied our normal provisioning policy. This strong performance is a credit to the quality of our authorization criteria, our collection staff and systems.

Similarly the impact of the new bankruptcy law appears to have been one of timing, with a significant reduction in bankruptcy notifications in December and January offsetting the increases in October and November. As a result, the bad debt charge at 5.9% of credit sales remain near the bottom of the historic range, and better than we had anticipated at the time of the Christmas trading statement.

Defined benefit schemes currently have a high profile, and I will summarize Signet's position. The UK scheme is the only defined benefit plan within the group, and was closed to new members in 2004. The IAS 19 present value of obligations rose last year by 33 million pounds, primarily because the longevity assumption was increased by about four years to over 85 for future pensioners. The fair value of assets grew by 20 million pounds so the pension deficit on the balance sheet increased by 13.6 to 15.5 million pounds before deferred tax relief. There will be a triennial actuarial evaluation in 2006/7, however, the IAS 19 figures already reflect the revised longevity assumptions that are likely to be used. Once the evaluation has been carried out, the revised contributions for 2006/7 and beyond will be determined.

Turning to the balance sheet, last year saw a largely stable underlying debt position, with closing net debt at nearly 100 million pounds, reflecting the 10.3 million adverse exchange impact with the closing dollar exchange rate moving from 1.89 to 1.77.

Income from operations increased to 188 million pounds during the, year reflecting some benefit from timing differences over the year-end. Capital spend was up by about 5 million pounds on an underlying basis, reflecting the increase to 9% of new stores space in and the U.S. However the net figure was down slightly due to the proceeds of 7.5 million from the disposal of the freehold of our North London offices.

In 2006/7 CapEx is expected to be between 80 and 85 million pounds. The highest tax cost reflects a return to a more normal payments pattern after favorable timing differences last year. Overall the broadly neutral cash flow was in line with our historic operating perimeter.

Going forward however, we expect this to change as a result of the further measured increase in the rate of store openings in the U.S., which more than offset the lower spend in the UK. We would anticipate a cash outflow of between 10 and 30 million pounds in '06 to '07 after payment of dividends. However, our balance sheet will remain strong, maintaining one of our key competitive advantages.

Our gross new space investment in the U.S. during 2006/07 is anticipated to be about $160 million. This is represented by between 70 and 90 million in respect to Jared, about $55 million for mall stores, and around 20 million in off-mall stores.

Strict operational and financial criteria continue to be applied to all store investment with the required internal rate of return well in excess of our cost of capital. By accelerating the space growth in recent years we have increased the division's operating profit, but reduced return on capital employed and fixed charge cover in the short-term. However our commitment to IRR on an individual store basis ensures we continue to add to shareholder value.

Dealing lastly with the group's funding. In 2006 our $251 million facility secured on the U.S. receivables amortizes, and we have therefore just completed a private placement amounting to $380 million of senior unsecured notes. These notes carry a slightly higher interest rate then the 5.4% from the old facility, but are on average a 10 year funding compared to five years under the securitization. Having repaid the $251 million, the balance of the funds raised will be used for general corporate purposes. The group's $390 million revolving facility for working capital purposes remains unchanged.

I will now hand you back to Terry, who will be pleased to take your questions.

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QUESTION AND ANSWER

Terry Burman *- Signet Group - CEO*

We would like to take questions from the room, and then we will go to questions from the conference call, and back to the room for any of those -- any of you that have any remaining questions. (OPERATOR INSTRUCTIONS).

David Jeary *- Credit Suisse First Boston - Analyst*

David Jeary, Credit Suisse. Can I ask you a little bit more detail about your experience in the UK and your e-commerce trial so far, and whether that is -- the experience of that has partly driven you to opening in the U.S.? And just for reference, will you count that in your like-for-like sales space going forward?

Terry Burman *- Signet Group - CEO*

In terms of the experience, I can put some more color on it in a minute. But both divisions plan their e-commerce launches based on the size of the market, which we have always said entering e-commerce would be a when not an if proposition for us.

There is a matter of the market reaching sufficient size that if we achieved our expected market share that we could earn a profit. That was developed based on those kind of projections and that kind of outlook. The initiatives were developed separately and proposed separately by U.S. and UK management. In terms of the UK the results have been encouraging so far. Rob, would you like to put some more color on that?

Rob Anderson *- Signet Group - CEO, UK Division*

Good afternoon. We launched our e-commerce site in August of last year. And in total we have been encouraged by the sales that we have achieved. What it has allowed us to do though is establish quite a good deal of learning before we launch the Ernest Jones site later this year.

What I mean by that are things like the average order value, average transaction value, the sales mix on the web, which was quite different to how we first anticipated it would be. Also in terms of method of delivery. So we have learned a lot about how many customers want to go into a store to receive it, have it delivered to their office, their home addresses etc., etc., etc.

Also systemically we have learned a lot. So it's going to be much easier this year for us to launch our Ernest Jones site. Finally, I don't know whether to carry on to the question about LFL sales. They will be counted in our LFL sales once we have anniversaried the launch in August.

John Ballie *- Societe Generale - Analyst*

John Ballie from Societe Generale. To answer that question in the U.S., about the Kay off-mall stores, could you give a bit of further detail about their growth performance and what they are achieving?

Terry Burman *- Signet Group - CEO*

Mark is with us here today, and I would like to ask him to talk about it. But I just think in general you have seen us follow this kind of pattern before. We have followed it with Jared. We are following it with the off-mall stores. We are following it with merchandising and any other initiatives, and that is we test before we invest. We have been testing this format for three years, and just the fact that we're expanding it at this level I think is an indication of its success. But why don't you talk a little bit about the off-mall concept?

Mark Light *- Signet Group - CEO, US Division*

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The off-mall concept, as you know, have been tested over the last few years. We opened 31 of them. And there are basically three different categories of off-mall concepts in the States. There is the traditional off-mall concept, which is dominated pretty much by grocery stores and a lot of community type of retailers. There is the lifestyle center, which is -- more the lifestyle center has a lot of the more upgraded type of tenants, typically Crate & Barrel or a William Sonoma and a lot of the restaurant shops. And then there's the power center, which is dominated by the big box retailers of the likes of Borders Books or a Toys "R" Us and so on and so forth.

In our first year of test we recognized that the comp that was working best for us were the lifestyle center and the power center. And so in years two and three of our test we have opened only lifestyle and power centers concepts. And those are the concepts that we're seeing as a good opportunity for us to grow going forward. And as far as sales, right now we are in line with our projections, and we're watching it very closely. And we're ramping this year's growth up to 20 to 25 stores.

Terry Burman *- Signet Group - CEO*

So what we have done is we have developed site selection criteria. So in the first three years, the first two years certainly, we were going by instinct, just our basic knowledge of real estate. We found out certain things about where to put stores and where not to put stores. And we now are comfortable with our site selection model, although it continues to become -- the more stores we open, the more we learn about it, so it continues to become more robust. But we are now comfortable with our site selection model so that we're more comfortable rolling out stores at a faster pace.

Jamie Isenwater *- Deutsche Bank - Analyst*

Jamie Isenwater from Deutsche Bank. Could you just give us a bit more clarity on the latest supply chain initiative, and what you expect to gain from going further down the supply chain, and sort of the scale that you can take out there? And what we should expect over the next three years in terms of impact on the P&L?

Terry Burman *- Signet Group - CEO*

What we can expect in the next three years as compared to what?

Jamie Isenwater *- Deutsche Bank - Analyst*

Compared to present where there is a substantial gross margin opportunity from going further down the chain.

Terry Burman *- Signet Group - CEO*

The primary objective here, getting closer to the mine, is to, and if you look at that chart what you say is that there is a lot -- in the presentation -- I forget which page it is on -- but the supply chain chart. What page is it on, Tim? He usually knows these by heart. I'm sorry to put you on the spot.

Tim Jackson *- Signet Group - IR Director*

Slide 21.

Terry Burman *- Signet Group - CEO*

Okay, so if you look at 21 what you see is between us, where we're buying most of our merchandise, loose stones from cutters and polishers, and some from jewelry manufacturers, there is a lot of trading that goes on in there. And each time these trades occur there's non value-added costs that is added to that merchandise. So that is a system that has been developed over years so that the right diamond in terms of quality get into the right hand. That is not the case, for instance, in the gold supply chain because the gold is just all one quality once it gets refined, so you don't need to do something like this in that supply chain.

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Getting closer to the mines could eliminate, or certainly will eliminate some of those non value-added tariffs that are being added. The difficulty we have though is now we are acquiring qualities that we may not be able to use, because consistent quality in our merchandise is a very important part of our selling system. When our sales people reach into the case, they know the quality of diamond that is coming out of there. And we don't want to get them off base by not having that quality.

So the P&L impact in terms of profit and loss is still to be determined because it very much depends on the proportion of diamonds that we get through this process that we can utilize versus those that we have to sell off. And when you have to sell off rough diamonds in very narrow parses, you're very likely to take a loss than even -- than getting a gain out of that. So it is that proportion that is going to determine what our profit and loss experience is going to be.

Certainly on a cash flow basis we're going to be holding that merchandise which we acquire through this system for about an extra 60 days. But our primary objective here -- we have always got a P&L objective obviously. We're trying to enhance our P&L. But our primary -- and interest cost and carrying cost will be one of the costs that we factor into our equation.

Our primary objective here is to be able to obtain consistent quality and supplies of loose diamonds, eventually cut and polished, to support our business. And our demands are increasing, as is worldwide demand for diamonds. And that demand is growing faster than supply is growing. So the benefit of achieving a more consistent supply, and ensuring that we have it is that we can support our selling system as our business continues to grow. And as I said to you that is an important -- a very important aspect of our selling system is to have consistent quality.

Jamie Isenwater *- Deutsche Bank - Analyst*

Help on what sort of margin those traders take out to the supply chain. Is it right to say 5 to 6% to the retail sales price or --?

Terry Burman *- Signet Group - CEO*

Actually that is something we're trying to figure out right now ourselves. So that is one -- that is an additional benefit because it gives us some better transparency into the lion's share of our diamonds. They are still -- the vast majority of our diamonds are still going to be bought from the cutters and polishers. But as we get into this manufacturing process and start understanding what happens at the cutting and polishing end, that gives us greater transparency and will help us negotiate better to the cutting and polishing side.

Jamie Isenwater *- Deutsche Bank - Analyst*

On the same topic of gross margin, I think most of the decline you have seen in the U.S. over the last couple of years has been pretty much mix. Can you tell us whether there are any more mix shifts to go forward to offset some of that mix issue, because I know obviously a lot of it has been done already?

Terry Burman *- Signet Group - CEO*

Yes, they become obviously the low hanging fruit. There was never much low hanging fruit, but the more obvious initiatives have been implemented. And as we go forward the more it becomes subtle. So it is going to more dependent on our ability to pass on -- if prices keep going up, and diamond prices have stabilized with more moderate increases recently -- but as this -- if commodity prices continue or do not, it is going to depend on our -- more on our ability to pass through the increases to the consumer.

David Jeary *- Credit Suisse First Boston - Analyst*

Just following up from Jamie's questions re gross margin, could you remind us in broad terms, because I'm sure it will only be in broad terms, what the proportion of gold and diamond is relative to your cost of goods sold please?

Walker Boyd *- Signet Group - Group Finance Director*

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In U.S. diamonds and gold together are around 60%, with about three-quarters of that, about 45% is represented by diamond and about 15, 16% is gold. Clearly the UK it is a much lower percentage of diamond, although the gold participation is about the same.

Terry Burman *- Signet Group - CEO*

Any other questions in the room?

Charles Allen *- Credit Agricole Asset Management - Analyst*

Charles Allen from Credit Agricole Asset Management. Just a question on the UK. I know it is sort of foolish to be carried away by one poor year, but the decline in footfall in High Street is something that seems that it might be a bit more than of a trend rather than just some like that. And so what terms have you got in the UK to perhaps address the footfall decline issue, and perhaps move more stores to places where we're people seem to be going, like particularly retail parks?

Terry Burman *- Signet Group - CEO*

We have tried retail parks -- and three of them. Is it three? In three locations. We're waiting to -- we are continuing to evaluate the efficacy of those locations. But not wild success, or else we will be continuing to expand them. But I do notice that according to retail trade magazines that it is becoming more normal for smaller store concepts to enter retail parks. So maybe it could be an evolutionary process.

In terms of our existing locations I just, as you said as you preceded your question, I would not get too carried away with one year. We're in the high traffic, we are in high traffic locations. And I think the retail traffic is very dependent on macroeconomic -- is dependent on macroeconomic conditions. Otherwise you are doing a market share and share of wallet battle. So I'm not willing to declare defeat on the UK economy based on one difficult year in retailing.

In terms of our outlook we don't see any significant reason for change in the immediate future. But offsetting that, we have to do some internal things to try and improve our business. We have got a heavy focus right now -- heavier than normal focus -- on merchandising and marketing initiatives. And we had some success, as you can see, over the Valentine's Day period in terms of slowing the rate of decline. We're also against weaker comps. And we will continue to improve our training, as we have said, and we will continue to remodel stores. And remodel stores' differential remains such that it satisfies our investment criteria for the increased investment. It remains about the same as it was pre this turn down in the environment.

So we think we have got a lot of initiatives we can continue to add to the business that will continue to drive performance. And in summary, as I have said, I'm not prepared to declare defeat in terms of the UK retail economy. These things -- economies are cyclical.

Any other questions from the room? Okay, we would be pleased to take -- operator, we would be pleased to take any questions on the conference call.

Operator

(OPERATOR INSTRUCTIONS). Steve Clark from RCM.

Steve Clark *- RCM - Analyst*

I'm just wondering if you could make a few more comments specifically regarded to U.S. consumer credit quality? And if you could try to make those kind of relative over the last six months or so that would be great.

Walker Boyd *- Signet Group - Group Finance Director*

(inaudible). I think as I said in my discussion the credit performance last year was very consistent with previous years, and indeed remains at the low end of our loss rate. Certainly in the last 10 years, net bad debt as a percentage of credit sales was about 5.9%. Which upon the graph, if you

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look back over the last 10 years is at the low end of our range, it has been about 5.6 to 7%. In terms of credit quality there I don't think anything -- any fundamental changes.

The other key statistic that we look at is the monthly collection rate, which is both a barometer of the consistency of performance of the portfolio, but also the depth of the portfolio. So I think monthly collection rate of about 14.5%, says we are still into relatively short-term consumer finance, at least on average the outstanding balance is about seven months to maturity.

We did it, again as I mentioned in the discussion, we did at the time of the Christmas trading statement flag the possibility that the tightening of the bankruptcy law in the U.S. in October might cause a spike in our loss rate. And we did see an increase in October and November of bankruptcy bad debt. However it does appear certainly at this stage that was purely a timing issue in the sense that the level of bankruptcies has subsequently reduced in December and January, such that the additional bad debt that we see -- as we might see during the fiscal year did not materialize. So overall I would say there is nothing in our credit portfolio that says there's any change over the performance of the loss debt several years, and indeed on a 10 year basis is still at the low end of our loss rate.

Operator

(OPERATOR INSTRUCTIONS). James Pan from CBE Partners

James Pan - ***CBE Partners - Analyst***

Just a series of questions here. The US$1 billion investment that you're going to make in working capital and expansion in the U.S. stores, does that include the rough diamond investment or the -- also diamond operation that you're thinking about, the one that is going to take another 60 days out of inventory?

Terry Burman - ***Signet Group - CEO***

No, it does not. Only to the extent -- well, it includes all working capital for the new stores. And to the extent that there might be a small tiny proportion of that -- of the rough that is allocable to the new stores, yes, they are included. But primarily, no, it does not include that initiative.

James Pan - ***CBE Partners - Analyst***

I think you mentioned an additional 60 days of inventory. What percentage of the inventory would it be? Is it going to be all those diamonds or just a small percentage of the test program?

Terry Burman - ***Signet Group - CEO***

Well it would be all of the diamonds that we buy. For instance, if we bought diamonds in the polished market, it might take 120 days to get them back into our stores in the inventory. Whereas if we bought completed merchandise from a manufacturer that merchandise hits the stores a couple of weeks after it is received in our home office. We get an extended period there.

So if 120 days is the time that it takes a cut and polished diamond to make its way into our inventory and get mounted in the rings and get into the stores, what we're saying is it might take 180 days for a rough diamond to make its way through the manufacturing process, then be set into the merchandise and then make its way into our stores.

James Pan - ***CBE Partners - Analyst***

What do you think the working capital investment increase would be for this program?

Terry Burman - ***Signet Group - CEO***

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It is not -- we don't want to say just how much we are purchasing in that fashion this year, but it is a very small, very small portion of our inventory this year, because we're just in the initial stages of testing. If and when it becomes meaningful to our balance sheet then we will be more open to discussing the impact on the balance sheet.

Walker Boyd - ***Signet Group - Group Finance Director***

I think what I would say is any additional cost in 2006/07 as we carry out the test that would be allowed for in the range of 10 to 30 million, which I gave as a range for cash outflow during 2006/07, so that would be factored into that number.

James Pan - ***CBE Partners - Analyst***

Okay, and the US$1 billion investment, how much do you think -- how much of that do you think is going to be internally generated from our operations?

Walker Boyd - ***Signet Group - Group Finance Director***

Well, again I think looking forward over the next five years will depend on the profitability of the business. Just looking out over the next twelve months you would say the vast majority of that is being funded because we would say a cash net outflow of between 10 and 30 million pounds for 2006/07 is after payment of dividends, etc., so the vast majority of that is being funded from the cash flow operations of the business.

James Pan - ***CBE Partners - Analyst***

And just follow on questions, because obviously you took on some debt recently, about 220 pounds worth or $350 million worth. You mentioned it is for corporate purposes. You have a very strong commitment to a strong balance sheet. What net debt as a percentage of EBIT -- what is your maximum ratio? How do you look at balance sheet safety, I guess is the question?

Right now you have about 100 million, 110 million pounds of net debt or something like that. Obviously you're probably going to draw down this debt that you're issuing to expand your --.

Walker Boyd - ***Signet Group - Group Finance Director***

Drawing down the private placement would not change our overall net debt number either in absolute terms, because remember net debt is net of any cash we hold, so it won't change the absolute number, nor will it change the gearing ratio, which at the end of the year was about 11%, which clearly shows that we have a very strong balance sheet.

We don't necessarily sit and say we have a maximum amount which we would put gearing. Clearly we have in the past when an opportunity has arisen, for example the Marks and Morgan acquisition that we made in 2000, at that time gearing I think went up 40% of shareholder funds when we funded Marks and Morgan as a result of the -- when we funded that through debt. So I think that shows that that we are prepared if the right opportunity comes along to gear up the balance sheet, provided that opportunity in itself is going to meet the investment returns that we set ourselves.

James Pan - ***CBE Partners - Analyst***

Maybe I misunderstood the reason for the placement. Are you just replacing your current debt or your short-term debt of 150 million with this piece of paper?

Walker Boyd - ***Signet Group - Group Finance Director***

The majority of the $380 million will replace the $250 million securitization which we have, which amortizes during the course of this year, and is fully amortized by the end of November of 2006. The balance we will carry effectively on balance sheet as cash deposit for certain parts of the

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year. Other times of the year, particularly through the month of August through to the end of the middle of November, clearly we have quite a significant increase in working capital requirement at that time.

The point of taking the additional funds, if you like it this time, is long-term rates are at historically low level, and private placement offered the possibility to effectively secure long-term finance over 10 years. And the Board believes it was appropriate to take that level of borrowing, given long-term rates as they were, and the opportunity to invest them over the next several years.

Operator

There are no further questions at this time from the telephone audience. I would like to hand the call back over to you for any additional remarks.

Terry Burman - ***Signet Group - CEO***

Any other questions from the room? All right, thank you for your participation.

Operator

That concludes today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

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