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SIGY - Interim 2004 Signet Group Earnings Conference Call

Event Date/Time: Sep. 01. 2004 / 9:00AM ET

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Signet Group plc - UK Jewellery Chief Executive

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PRESENTATION

Terry Burman - Signet Group plc - Group Chief Executive

(Indiscernible) those of you joining us by webcast and conference call. I am Terry Burman. I am the Group Chief Executive, and with me is Walker Boyd, our Group Finance Director. Sitting in the front row is Rob Anderson, our UK Jewellery Chief Executive. First I will present an overview of the business and then Walker will summarize our results. We will all then 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 plc - Group Finance Director

(technical difficulty) statements regarding such things as (indiscernible) 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 described on Slide 2 of this interim results presentation and in the "Risks and Other Factors" section of the Company's

2003-4 annual report on Form 20-F, filed with the U.S. Securities and Exchange Commission on April 22, 2004, 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 or future changes make 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 that affect 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 40 and 41 of this interim results presentation or to the Company's earnings release dated 1 September, 2004, available on the financial information section of the Company's website at www.signetgroupplc.com.

Terry Burman - Signet Group plc - Group Chief Executive

Thank you, Walker. The group interim results were driven by a strong like-for-like sales performance and continuing control of gross margin expenses, which created operating leverage, particularly in the U.S. The strong performance more than offset the adverse movement of the U.S. dollar exchange rate, which has moved 14 percent, from \$1.61 to \$1.83, and has had a negative impact on reported results of 5 million pounds.

Total sales grew to 672 million pounds, representing a 10 percent increase at constant exchange rates. Like-for-like sales rose by 7.4 percent. Profit before tax rose to 53.9 million pounds, up 27.1 percent at constant exchange rates. This included the 1.7 million pound non-recurring restructuring charge in the UK. Earnings per share group to 2 pence. The Board has declared a 10 percent increase in the interim dividend to 0.375 p per share.

And now turning to the U.S. business. The 13 percent increase in U.S. dollar sales was driven by the 8.2 (ph) percent like-for-like growth in new space. Operating profit grew by 28 -- growth and new space -- sorry. Operating profit grew by 28.1 percent at constant exchange rates to 54.7 million pounds. Operating margin rose to 11.6 percent, with expense control and leverage from like-for-like sales growth more than offsetting the impact of new space. Gross margin was broadly maintained with the benefit of management initiatives,

FINAL TRANSCRIPT

SIGY - Interim 2004 Signet Group Earnings Conference Call

including price increases offsetting higher commodity prices. Bad debt fell to 2.5 percent, at the lower end of the range of the last five years.

Now I will look at some of the main drivers of this performance. Merchandising initiatives included expansion of the Diamond right-hand ring category and the Leo ranges. In the gold category, new designs, displays, training, and advertising were introduced, and we are working with the World Gold Council to reinvigorate sales of our gold category.

In Jared, we continue to see good progress in luxury watches, including increasing the number of stores selling brands such as Rolex, Omega, and Tag Heuer. As part of the world-class store systems initiatives, special orders and repair systems have been improved to enhance customer service and reduce in-store administration. And the period saw a 9.9 percent increase in the average unit selling price, reflecting changes in product mix driven by our merchandising strategy and higher prices, as well as greater participation of Jared in total sales.

The jewelry sector saw the gold price move from about \$340 to an average of \$400 per ounce during calendar 2003. So far in 2004, the price has been relatively stable. Rough diamond prices have seen a steady increase over the last 12 months, the magnitude varying depending on the size and quality of the stone. Some of the rise in commodity prices has been absorbed by the supply chain, particularly for larger retailers. The sector's slow inventory turn and hedging policies mean that retailers do not have to react immediately to each fluctuation in commodity prices.

Jewelry purchases usually have an inelastic volume response to pricing, driven by the predominantly bridal-related and gift-giving nature of the sector in which Signet operates. In the first half of 2004, price increases were implemented by Signet and others in the industry. These varied across our range, depending on the gold and diamond content and the labor element in manufacturing. These price changes, along with other initiatives such as sourcing and tighter discount controls, contributed to the broadly maintained gross margin achieved in the first half.

To get the right people, we have invested in our field recruiting by establishing a central facility to complement store-based hiring. Another initiative has been the development of online training methods, which is an aspect of our world-class store systems. As a result of our focus on training, we now have at least one qualified diamondtologist

available in every store. And training has been focused on the ultimate diamond presentation, which sharpens the diamond-selling skills of associates. The program is supported by a divisionwide training schedule, standardized class materials, and central monitoring of individuals' progress.

We have talked a lot about training in the past. It is a difficult thing to get across in a presentation like this, so today, we would like to show you an actual training video. And the person that is representing the salesperson in the training video is actually one of our salespeople, but it is a role play that you will see.

This is -- I am not telling you that this is the kind of presentation that you will see in every one of our stores, if you went into every one of our stores, by every one of our salespeople. But this is the standard to which we are trying to lift all of our salespeople. The video depicts, as I said, a role play and highlights of selling methods and skills. It is just a portion of our training video. And in this example, the customer has some knowledge about diamonds. So there are different role plays for different types of customers that come into the store -- some that don't know anything about diamonds; some who have some basic knowledge; some who are more technically oriented; some who are more looking for the sparkle or the style or the fashion of merchandise.

The sales associate serves the customer, as you will see in this, using a detailed diamond expertise, but also all of the resources and tools that he has available to build confidence by the customer in the store, the staff, and the product. So here we have this video.

(Video Presentation)

Our strong sales performance at Valentine's and Mother's Day were supported by increased marketing and advertising. National television is highly effective and continues to build favorable Kay brand awareness. Regional brands benefited from a comprehensive radio advertising program. For Jared, the number of markets in which local television advertising was used rose from 10 to 22, covering about 75 percent of sales. In both the mall and Jared divisions, advertising costs as a percentage of sales was maintained in the first half compared to the prior year.

We continue to invest and improve the Kay and regional brands real estate. 34 mall stores were refurbished or relocated, continuing the steady program to improve the portfolio, with 51 planned for the remainder of the year. 16

FINAL TRANSCRIPT

SIGY - Interim 2004 Signet Group Earnings Conference Call

Kay and eight regional stores were opened and 21 further mall stores were scheduled for the second half. We have agreed sites for 10 more off-mall Kays, bringing the total to 20 by the year-end.

The Kay off-mall initiative, which is at an early stage of development, is still showing positive results. So far, we have found that the off-mall format benefits from Kay's strong branding. The average ticket price is somewhat higher than in the malls, and the household income is a notch above our average mall customer. The store openings this year will be focused on lifestyle and certain types of power strip centers. We are analyzing the performance of the stores to determine the specifics of the best sites and locations.

Jared's performance has continued to be very encouraging. Those stores which are in their second to fifth full year of operation have further narrowed the gap on their sales pro formas. Stores in the first full year are currently ahead of their pro formas. By Christmas, there will be a total of 94 Jareds. The new store opening program has been stepped up to 15 in 2004, against 12 in each of the last three years. New types of locations for Jared are now being tested. These include markets with increased density, smaller markets, and we even have a new Jared located in a mall site.

Frequently, Jareds are situated close to the main vehicular entrance to regional malls and visible to high-traffic streets. Developers are increasing sites attached to malls that are suitable for category killers, and this will increase our opportunities to open Jared. This is a new mall that you see pictured in Des Moines, Iowa, where Jared is located at the main entrance. It is near high-traffic restaurants, with excellent visibility from the car park and the street, and has access from the car park and from the mall itself. This type of location has all the attributes of a non-mall Jared's site plus the advantage of exposure to mall shoppers.

Our plans for Christmas in merchandising are further enhancing the Leo Diamond range by stocking new styles, extending the range of diamond cuts and sizes, and introducing the Leo Artisan, a higher quality stone with an enhanced cut, in most Jareds this year. We are further developing the range of the diamond right-hand ring, for which De Beers is boosting its advertising. Again in collaboration with the World Gold Council, we are expanding our gold initiative beyond the initial test stores. Jared will have more luxury watch brands, and other initiatives include a wider selection of larger sized diamond solitaires, natural colored gemstones, and in Jared, more loose stones. Overall

inventory will be increased in line with sales, with a greater proportion in-store, due to improved central inventory procedures.

In marketing, the number of Kay TV advertising impressions will again be increased. For the first time, cable will also be supported by national radio campaign, and print ads will be stepped up. In Jared, successful local television advertising will be expanded at Christmas to cover 90 percent of sales. Sales associates are also well prepared. Diamond sales training has been increased and staff time has been freed up for selling and customer service rather than administrative tasks.

Over the last five years, Signet's market share has increased from 5.1 percent of the specialty market to 6.9 percent. While the market data for the first half is not yet available, we are confident that our market share will have increased again. We believe that we are well-positioned to compete over the important Christmas season.

Now moving on to the UK business. Like-for-like sales were up 5.5 percent in the first half, with H.Samuel up 3.6 percent and Ernest Jones up nearly 8 percent. The business again outperformed the general UK retail sector. Reported operating profit declined to 7 million pounds, but this included the 1.7 million pound non-recurring restructuring charge, about which Walker will give you more details. Operating margin increased to 4.3 percent, excluding the restructuring charge. Gross margin was ahead of last year. A total of 52 refurbishments or resites have been completed in the first half, with a further 33 by Christmas.

Our drive to grow diamonds in the sales mix moved ahead, with H.Samuel up 170 basis points and Ernest Jones up 160 basis points. The UK was up overall 2 percent, and that is obviously due to the sales mix shift to Ernest Jones. Average selling price rose 4.7 percent in H.Samuel and 2 percent in Ernest Jones. Improved visual merchandising with better product adjacencies and new display elements also helped grow diamond participation.

We continue to enhance our customer service by increasing training, with a comprehensive program supported by clearly defined operating standards. Therefore, it was very pleasing that UKJ (ph) were seen as leading the industry by the Chief Independent Examiner. Over 1000 staff will have passed the first level of the externally accredited element of our program by the end of the year.

FINAL TRANSCRIPT

SIGY - Interim 2004 Signet Group Earnings Conference Call

As well as increasing training, we are developing and implementing clearer career paths for sales associates, which also improves motivation. As a result of these steps, we have reduced staff turnover by 13 percentage points in the last two years. We are also testing new incentive programs and different staffing levels to optimize customer service.

Our two brand identities of H.Samuel as the nation's favorite jeweler and Ernest Jones as the diamond and watch specialist are evolving. As part of this exercise, we have carried out a communications audit and updated the visual design elements for both brands. In addition to improving the design and distribution of catalogs in the first half, a customer relationship marketing trial was successfully carried out for Ernest Jones, and it will be expanded in the second half.

We are now in the rollout stage of our new format stores. In the first half, we remodeled or relocated 52 stores, compared to 4 in the comparable period last year, and they continue to deliver encouraging results. We've shortened the closure period required for refurbishment. As planned, about 85 stores will be refurbished or relocated by the end of 2004, and 10 new stores will be opened. The new stores will include a three-store test in retail parks.

These centers have been developed for a number of years and are generating significant customer traffic. However, we need a smaller-than-standard unit, and as such, sites have not been available until recently. This year we have identified sites that are suitable to open one Ernest Jones and two H.Samuel stores. Here you see the site map of Becton in East London and the location of the H.Samuel store that will be opening later this year.

As regards our plans for Christmas, the Forever Diamond will be expanded to all H.Samuel stores, while in Ernest Jones, the Leo range will be increased with new cuts and styles. We will have in place better trained and qualified sales associates to deliver improved customer service. In addition, television advertising for both brands will be expanded in 2004, with sales coverage of 66 percent for H.Samuel and 59 percent for Ernest Jones. At Christmas, 30 percent of sales will be from the new, updated store format.

So in summary, the group has established a track record of success, which has continued through the first half of this year. We have a culture of continuous improvement and excellence in execution across the business. We are in a position of strength to compete in our markets, with the strongest brand names, industry-leading operating ratios, a

strong balance sheet, and proven strategies for growth. While there has been some softening in the trading environment in August on both sides of the Atlantic, this is not necessarily indicative of trading prospects for the balance of the year.

As I have described, our businesses continue to implement a range of initiatives and are well-positioned to compete during the important Christmas season. Now I would like to ask Walker to review the financials.

Walker Boyd - Signet Group plc - Group Finance Director

Good afternoon. Group operating profit for the six months at 58.6 million represents an increase of 22.9 percent at constant rates. This strong performance is underpinned by the like-for-like increases on both sides of the Atlantic and results in an increase in operating margin of 70 basis points to 8.7 percent. Correspondingly, pretax profit, again on a constant exchange basis, increased by 27.1 percent, or 13.7 percent on a reported basis.

Sales growth in the U.S. was 13.1 percent at constant rates, with new space contributing 4.9 percent. Adverse exchange rate movements from an average of 1.61 (ph) to 1.83 offset this increase on a reported basis. In the UK, like-for-like growth of 5.5 percent was somewhat mitigated by the impact of the expanded store remodeling program, which was a major factor in the 1.4 percent decline in space terms.

Looking at the geographic split, U.S. operating profits grew to 54.7 million and operating margin of 11.6 percent. In the UK, excluding the impact of the non-recurring restructuring charge, there was a further improvement in operating profit at the half-year to 8.7 million, a margin of 4.3 percent.

Analysis of the factors behind the increase in operating margin shows that the U.S. improvement reflects the benefit of continued tight expense control and the leverage provided by the 8.2 percent like-for-like sales increase, resulting in a reduction of 180 points in SG&A. The benefit of a range of margin initiatives undertaken, including the pricing increases in the first half, resulted in gross margin being broadly maintained.

In the UK, gross margin rate was improved by a further 50 basis points. Expense ratios were adversely affected by the increased closure periods as a result of the increased modernization program, which is a main factor behind the 30 basis point increase.

FINAL TRANSCRIPT

SIGY - Interim 2004 Signet Group Earnings Conference Call

During the first half, we have provided for the non-recurring costs of consolidation of staff and administration functions in our Birmingham facility. This will involve the relocation of some 85 positions from our North London offices. The process is progressing in line with our internal plans and is expected to be largely completed by the end of the third quarter of this year, at a cost, as anticipated, of around 1.7 billion (ph) pounds. Going forward, we would expect the UK business to benefit by some 600,000 pounds per annum.

Before dealing with the balance sheet, let me deal with the revenue recognition restatement, which applies to the accounting for our extended warranty program in the United States. Our previous policy was to recognize revenue at the time of sale, making provision on an incremental basis for the expected cost of meeting anticipated future claims. In line with application note G, an amendment to FRS 5, we will now spread the recognition of these revenues over the anticipated period of claims, and therefore recognize profit on such agreements over the same period.

As a consequence, we have restated prior years, and this is reflected in the reduction of 2003 for full-year profits of 7.2 million to 204.7 million. With regard to the current year, we anticipate the reduction of 5.8 million from that which would otherwise have been reported. In respect to the balance sheet, we have made a prior-year adjustment of 35.1 million pounds, representing some 4.8 percent of net assets.

Turning to the balance sheet. Although cash outflows during the first half of this year are higher than 2003/4, net debt at 31 July of 131 million pounds is below last year and represents gearing (ph), including the U.S. securitization borrowings, of some 18.3 percent against 23.9 last year. Excluding our securitization borrowings, we remain in a small net cash position at the half-year.

The increased outflow in the first half is attributable to three factors. Firstly, inventory increases reflect the impact of additional space growth in the U.S., together with an underlying increase of around 3 percent, well below the level of like-for-like sales increase. Secondly, the anticipated increase in capital expenditure, reflecting not only the new space impact in the U.S., but also the move to the rollout phase of the UK remodeling program. And lastly, the cash impact of the increase in last year's final dividend by 20 percent resulted in an increase of 6.5 million pounds.

With regard to the outlook for debt for the full year, we remain on-track for a broadly neutral position. We continue to

anticipate a group capital spend of around 80 million pounds, which, together with the working capital implications of the expected 8 percent space growth in the U.S., should be funded from the operating cash flows of the business. We therefore expect to see some further reduction in gearing at the year-end, maintaining our strong group balance sheet position. And I'll hand back to Terry to take questions.

Terry Burman - Signet Group plc - Group Chief Executive

Thanks, Walker. We will now be happy to take any questions from the audience. We will start with questions in the room, then those who are joining us by conference call, and then back to any final questions from any of you in the room. We request that you please identify yourself by raising your hand. Tell us your name and your organization, and wait for the microphone before you ask your questions.

QUESTIONS AND ANSWERS

David Jeary - CSFB - Analyst

David Jeary, CSFB. I wonder if I could ask a couple of questions, please. One, Terry, just going back to what you were saying about price rises -- and I appreciate that they differ a lot across categories -- but I wondered if you could give any kind of average idea, if that's possible. And secondly, re your comments on current trading, I just wondered if you were aware of any specific, particular aspects that might have changed year-on-year, other than the fact that you're running against toughening comps? And also, whether you'd be prepared to say whether they're still in positive territory on both sides of the Atlantic.

Terry Burman - Signet Group plc - Group Chief Executive

In terms of price increases, gold is up about -- our average gold price is up probably in the 15 to 20 percent range. That is for the gold commodity. In diamonds, first half versus first half last year, I am going to give you the rough price increases first. Average rough prices in the market are up about 15 percent. Now, as I said in the presentation, we have managed to contain some of those price increases by passing them on to the supply chain. We are an attractive customer. We are a very powerful buyer, and we used our buying power to be able to negotiate some better pricing on that. So that is in terms of the commodity prices. Those are the lifts.

The offsets, and the way in the U.S. we have been able to manage our gross margin to broadly flat to last year, is by the price increases that we took, along with many others -- most others in the jewelry industry, better control of store discounting and some sourcing initiatives. In terms of more direct sourcing, we did a little -- we have been doing some assembly ourselves of some of our products, so thereby averting some of the manufacturing premiums. Getting our vendors to source in more cost-effective markets -- there is a whole range of various sourcing initiatives that we implemented. And the combined total of all of these things allowed us to come out with a reasonably healthy margin compared to prior year.

I would stress, however, that the cost increase, the commodity price increases have not fully -- because we are work on an average cost basis for our inventory -- and they have not fully worked their way into our inventory yet. So does that take care of your pricing questions?

David Jeary - CSFB - Analyst

Just wondered whether at actual retail selling price level, what the net impact was, if you could quantify roughly what you have put your prices up by, H1 on H1?

Terry Burman - Signet Group plc - Group Chief Executive

We just don't look at it like that. We're looking category-by-category, and frankly, we're looking SKU by SKU to see. Because you have to be careful with these kind of things. What is the proportion of gold as a percentage of the end product? What is the proportion of diamonds as a percentage of the end product? And not all diamonds are going up at the same price levels. What is the proportion of colored stone in the mix, and those have been pretty stable on prices. So we need to be careful. Otherwise, we buy these and merchandise these products and advertise them thousands at a time, but the salesperson has to sell them one at a time. And each piece needs to be price-competitive and each piece is dependent upon the cost and the retail need to be dependent upon the mix of elements that go into making up that piece.

So I couldn't tell you what price increase was in total. I can tell you that -- we work this out. This might be meaningful for you. Our average price increase was about 10 percent. About 2 percent of that was due to Jared mix. And these are rough figures, but about half of the balance of the increase

in the average unit price would be attributable to price increases, and about half the balance of the increase is attributable to lifting average price points for our customers through merchandising initiatives. So when we are stocking bigger diamonds, that obviously tends to lift your price points. Does that give you the information you need, David? Okay.

In terms of year-on-year changes for August, there were changes in both markets in August that could impact the month of August. I want to stress that we are seeing some softening in the general environment, and we were impacted by it in August compared to the first half. The month of August is a very small month, unlike clothing, which is dominated for back to school. It is a significant month in the clothing industry. In jewelry, it is not. There is not a lot of reason for gift giving. People are traveling a lot. And as a small month, subtle changes can have a more dramatic impact on the month than in a larger buying month.

The unique things to August in the U.S., certainly the hurricane in the Southeast took the top off some of our sales. The noncomp, if you will, of the stimulus from tax refunds in the prior year versus this year, certainly we believe there was not the stimulus this year and certainly probably impacted our sales. And let's see, we also had the change in the holiday, the timing of the holiday. So that changes people's travel plans and changed back-to-school dates and can have an impact, can influence our sales.

In terms of the UK, fewer one-offs, but certainly the timing of the holiday. But the same dynamic is present; it is a small month for us. And in the UK, we did have certainly in one of the divisions a very strong August last year. So the fact that we are up against more robust comps in both U.S. and UK could have influenced us. So it is what it is. We give you a comment about prospects at the half, and we are doing so this year, but we just want to call your attention to the fact that this is not necessarily predictive of the Christmas season.

And in terms of specific numbers, no, we don't comment midquarter on our actual results.

Richard Edwards - Citigroup - Analyst

Richard Edwards from Citigroup. Just following up on the price inflation point. In the second half of the year, you're expecting to raise prices to a greater degree than you have in the first half. Could you give us some color on that? Second question, just on the UK. You gave us some numbers on TV

FINAL TRANSCRIPT

SIGY - Interim 2004 Signet Group Earnings Conference Call

advertising coverage for the year as a whole, for HS and EJ. Could you remind us what those were a year ago, just so we understand how those have changed?

Terry Burman - Signet Group plc - Group Chief Executive

Sure, let's see. In terms of raising prices, we do have a category of merchandise that we will be raising that we did not raise in the first half. But the current costs of the commodities, the diamonds and gold, are already built into our price increases. So except for one category -- this is a logistical nightmare for us, trying to change all these. You can imagine how many tickets and things have to be changed and how it has to be done, the inventory records that have to be changed. But there is one category that still needs to be changed. But in terms of the price increases, unless we would see some significant shift again in commodity prices, the prices are set -- will be consistent with the first half. The ad coverage was -- Rob, can you help me?

Rob Anderson - Signet Group plc - UK Jewellery Chief Executive

25 percent (inaudible).

Terry Burman - Signet Group plc - Group Chief Executive

I'm not sure if you could all hear Rob, but he said 25 percent in Ernest Jones and 40 in HS last year.

Andrew Hughes - UBS - Analyst

Andrew Hughes from UBS. Just another one on the price increases. Looking at your like-for-like transaction numbers, they dipped slightly in the U.S. in the first half. Does that bother you at all or is it really a metric you look at?

Terry Burman - Signet Group plc - Group Chief Executive

They actually increased slightly.

Andrew Hughes - UBS - Analyst

I thought your average transaction value was up 9.9, (multiple speakers) like-for-like.

Terry Burman - Signet Group plc - Group Chief Executive

2 percent of that was due to Jared's shift. There was a mix shift into Jared. So if you take the mall stores and just took -- in comps stores, the number of transactions and the number of Jared transactions, totaled them all up this year versus last year, it's slightly ahead -- a few tenths of a basis point.

Andrew Hughes - UBS - Analyst

But that is something that you do monitor and try and target, or is it just almost a residual from other things that are going on in the business?

Terry Burman - Signet Group plc - Group Chief Executive

We definitely monitor it. We do -- down to customer counts in Jared, where we have people counters at the doors so we know exactly what our traffic counts. And it is something we very closely monitor. Obviously, we're trying to drive -- we are always trying to drive traffic counts. It is a combination of trying to drive traffic counts, average unit sales; we're trying to drive add-on sales or multiple unit transactions, and we're trying to drive higher price points. So we focus on all of those metrics and they are certainly all important to us.

Andrew Hughes - UBS - Analyst

On a completely different topic, one for Walker. Anything that you work on IFRS so far has thrown up that you think is going to be a particular issue at this point?

Walker Boyd - Signet Group plc - Group Finance Director

In relationship to IAS generally, -- I think the major change that we will have to make is accounting for (indiscernible) by everybody else. I think there may well be some reallocation in terms of revenue recognition, but I think the major one in respect to revenue recognition is the change we have made this time. So as I say, I think the major one going forward for IAS is going to be accounting for share (indiscernible).

Andrew Hughes - UBS - Analyst

What is the (indiscernible) on leases?

FINAL TRANSCRIPT

SIGY - Interim 2004 Signet Group Earnings Conference Call

Walker Boyd - Signet Group plc - Group Finance Director

Leases -- under the terms of our leases, I don't think the IAS is going to have a major impact on us.

Andrew Hughes - UBS - Analyst

Why is that, just as a point of interest?

Walker Boyd - Signet Group plc - Group Finance Director

In terms of the nature of our leases, I don't think when you start analyzing between land and buildings, which is basic, that we would still regard either of these as likely to be financed (ph).

Andrew Hughes - UBS - Analyst

Okay, thanks.

Unidentified Audience Member

could I just build on Andy's question and ask the same question about transaction values in like-for-likes for H.Samuel? Because it appears that you have had fewer transactions in H.Samuel in the half, again just how concerning do you think that is? Like-for-like's up 3.6 percent and average selling price up 4.7 percent.

Terry Burman - Signet Group plc - Group Chief Executive

All right, yes. As we shift into more diamonds, we are also deranging the giftware category. And the gift and collectibles are the lower-priced items, and obviously, the diamond category is higher priced. So this is a trend that I would expect to continue at H.Samuel, especially as we remodel the stores into the new store format where the gifts really have to be deranged because of the space restrictions. We are shifting our business. The business is evolving. And these kind of metrics that you would look at in a consistent store format by another retailer, we all have to be careful about how we look at those and interpret those vis-a-vis H.Samuel, especially where the biggest changes are occurring, and somewhat in Ernest Jones.

Abid Riaz - Panmure Gordon - Analyst

Abid Riaz, Panmure Gordon. Just a question on your new Jared testing locations. You talked in the (indiscernible) about Jared and the fact that most of us have seen the stores off-mall separate location, (indiscernible) stores five times more stock and all the other dynamics that go into that. It's interesting to see that you're testing out a mall site. How's that fit in with the whole concept?

Terry Burman - Signet Group plc - Group Chief Executive

We will select a mall site as long as it retains the attributes of the successful site selection criteria that we know for Jared, and that is good access, good visibility to a high traffic street, its own entrance off a car park. And more and more malls are turning to category killer type space to replace the space occupied by department stores and other traditional draws to malls. So this is one of the things that malls are doing to try and offset the mix shift from mall to off-mall. They are making their malls, they are building malls or remodeling malls so that they are appropriate for some of the formats that have always been off-mall to come onto the mall. And we think that since this is a shift by landlords and it is one that is probably going to continue, that we should test that kind of format and see how we do when we are attached to the mall.

The significant restriction is that we're not going to open Jared -- or we don't have designs of opening Jared in a traditional mall location. We're going to retain the elements of success that we know are driving the success of Jared and attracting the kind of customer that Jared has built its success on. So as long as we can get both elements, the traditional off-mall element plus the mall element as an add-on, we think that that should help drive a successful location for Jared.

Abid Riaz - Panmure Gordon - Analyst

The whole concept you've got -- the service station within there, you've got the kiddies area -- obviously, they take up a lot of space. How's that working in a mall site, which (indiscernible) would be a lot smaller?

Terry Burman - Signet Group plc - Group Chief Executive

First of all, the store is the same. It is the same prototype, same design. If I blindfolded you and took you in, you wouldn't

notice the difference if it was mall or off-mall once you were inside the store.

In terms of the cost, the cost is competitive on category killer type sites as it is in off-mall locations, so we're not paying a mall rent for this. This is an off-mall type of rent. And landlords understand in order to attract the category killer type formats into their malls, that they have to provide rents that are competitive with other off-mall sites.

Unidentified Audience Member

(indiscernible) from Deutsche Bank. Could you talk about your plans for Jared openings for next year, and whether there's anything you can say about the test (ph) of increased density in smaller markets? And secondly, on marketing, you mentioned that you are increasing the spend on print advertising for Kay's, which seems a slight change in emphasis; the last few years, you have been reducing print in favor of TV advertising.

Terry Burman - Signet Group plc - Group Chief Executive

In terms of Jareds, we plan to open 18 next year. That is in our preliminary budget. What was your second question?

Unidentified Audience Member

On Jared, the trials of the smaller markets and increased density, whether there's anything you can (multiple speakers) have discovered from that so far.

Terry Burman - Signet Group plc - Group Chief Executive

Not yet, because there is one store we have not found. And one of those tests, the mall test obviously we just opened. And the third test, that store hasn't opened yet. So we don't have any feedback yet on that. And the third question was --

Terry Burman - Signet Group plc - Group Chief Executive

More print. As our sales lift, on the back of that, we have a higher advertising budget. So let us say Kay's sales were up, just for sake of argument, let's say they were up 10 percent last year, and let us say we increased our print advertising by 5 percent. There is still a mix shift to broadcast, but it still gives us the opportunity to increase our print advertising. So it is not a mix shift, it is just we believe in a multimedia advertising

plan. Print is part of that. We found an effective media in which to place some of our print advertising, and that is in USA Today, especially at the peak periods. So we think it is a good support for our other program and reinforcement of our other advertising programs.

We're also excited about the radio, the national network radio program that we're going to be doing for Kay. Kay has only been on radio in a few spot markets, supported by radio in a few spot markets, and now the whole division is going to be supported by radio. Again, it is part of that multimedia strategy, so that the customer sees Kay when they are watching TV, hears about Kay when they are driving to and from work or to and from the mall, and may read about Kay when they pick up a newspaper. So it is just about continuing to reinforce the brand, build brand name awareness, and with the products (indiscernible) build purchase intent.

Lucy Sharma - UBS - Analyst

Lucy Sharma from UBS. Just to clarify, are you saying that commodity price increases have not yet come through fully, so therefore you'd expect some of that to flow through to the second half, but also saying that prices generally are going to be in line with the first half, obviously implying then your gross margin is going to be down for the second half in the U.S. I was just wondering whether you think there's enough initiative for supplying power that you have that can offset that, so you get a similar gross margin outcome as you did in the first half.

Terry Burman - Signet Group plc - Group Chief Executive

I know what you said, but I think you heard it right. What I said is commodity prices have not fully been reflected. It is not that they are not in there. It is that they have not fully been reflected because it's take time to average up the inventory.

In terms of your question, which is really about where do we see gross margin, we would see some slight reduction or small reduction -- I will say small reduction in gross margin rate for the second half in the U.S. because of higher commodity prices, but this is not an exact science. Much has to do with sales mix, sales mix between product, sales mix between products within the same category even, can change this. But we would for the second half expect some small adverse movement in gross margin rate.

FINAL TRANSCRIPT

SIGY - Interim 2004 Signet Group Earnings Conference Call

Lucy Sharma - UBS - Analyst

On the UK, now you've got over 100 of the stores in the new format, and I'm just wondering whether or not you can expand on the (indiscernible) you're getting from those stores versus the average?

Terry Burman - Signet Group plc - Group Chief Executive

Let me expand on it. We are pleased with the results. Pleased enough to continue the investment. You know what are hurdle rates are for capital investment -- over five years, 20 percent on a discounted cash flow basis. So obviously, we're getting enough lift to justify continuing the investment. We certainly are not exactly -- I would call us a more cautious lot than people that like risk, so you know that we have tested it well and we know that the results are coming through; otherwise, we would not invest this kind of money in this new store format. The capital budget for the UK this year is 35 million pounds. Part of that is catch-up for the last couple years, where we have delayed some of our remodels due to trying to make sure we got the format right.

The other advantage of these remodeled stores is we get an extraordinary lift. They are particularly effective in driving diamonds sales, which is the direction in which we want to take our business, because we think that that is the best place for us competitively and within the marketplace. Why do we want to take our business to more diamonds and jewelry? Well, we want to take it there because it plays to our strengths. It is hard for us to compete on generic product with huge stores that are paying lower rents per square foot. They are paying -- they have got less help. They are delivering lower quality of customer service. And if we have to compete on a commodity basis like that with these huge stores that are driving sales by price, frankly, that is not our strength.

Our strength is going to be to compete on the High Street and in the malls on a selection, service, and extraordinarily good marketing basis -- reputation basis. And those are our strengths and that's where we want to take the business. So it is not just some whim -- we thought -- finger in the air, we thought it would be a good time to go sell diamonds or more jewelry. These are our strengths. These are our business strengths. These are our competitive strengths, and that is the basis on which we want to compete. And we think we can do so quite well and quite effectively. The results are certainly coming through on that basis, so that is the essence of our strategy.

John Baillie - SG Securities - Analyst

John Baillie from SG. Could you just give some guidance on the sales contribution from space in H2 in the UK and in the U.S. against that -1.4 in the UK and plus 4.9 in the U.S.?

Terry Burman - Signet Group plc - Group Chief Executive

Space in the UK is about flat.

Walker Boyd - Signet Group plc - Group Finance Director

During the first half and in (ph) the third quarter, when we continue to do the remodeling program, then we will have -- again in the third quarter, we will have more stores closed for remodeling than last year. By the time we get to the fourth quarter, when clearly the annual program will be complete, then space should be about flat. So I would (ph) have thought for the year as a whole that 1.4 will be on the high side, because the fourth quarter, I would expect space in the UK to be broadly flat. The U.S., given that we're increasing space in about the same proportion, maybe even slightly higher than last year, then I would have thought the 4.9 that we got in the first half is going to be in that 4.5 to 5 percent range for the second half.

Terry Burman - Signet Group plc - Group Chief Executive

Any other questions from the floor?

Unidentified Audience Member

Can I -- just as one final accounting question on FRS-5, the numbers you've got in your press release. It says on the change that you lost sales of 7.4 million and lost profit of 7.2. Am I missing something or are you virtually 100 percent EBIT margin on the warranty business?

Walker Boyd - Signet Group plc - Group Finance Director

We're not 100 percent margin. I think looking at the way we provided in prior years, which is I said was on an incremental cost accrual basis, during '03/'04 when we looked at the cost of meeting our future claims, there was not a significant increase because we were looking at -- the incremental labor cost was virtually zero. So last year was a bit odd in the sense that our the increase in provision year-on-year that we made

SIGY - Interim 2004 Signet Group Earnings Conference Call

under the previous policy was a very small increase. So effectively, when you reverse that out and go to a new policy, then it has that effect. And it is not reflective of what the gross margin would be on ESP (ph).

Unidentified Audience Member

But can we assume, given that you're losing profit, is that warranty revenue has been rising over the last few years within the mix?

Walker Boyd - Signet Group plc - Group Finance Director

It went through a period in the late '90s when it was increasing participation. The last two to three years, it has actually been increasing basically in line with the rest of sales. So it has been increasing, but not as a proportion of total sales.

Unidentified Audience Member

Thanks.

Terry Burman - Signet Group plc - Group Chief Executive

I'm glad you understand that one, because I struggle with it. Any other questions from the floor? Okay, now I would like to invite anyone on the telephone lines that would like to ask any questions to please do so.

Operator

(OPERATOR INSTRUCTIONS) There are no questions at this time, sir.

Terry Burman - Signet Group plc - Group Chief Executive

Not a very curious lot or else you covered it all. Thank you very much for the questions. Are there any final questions? Thank you very much for your questions. Thank you for your attendance. And look forward to seeing you later in the year.

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