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Conference Call Transcript

SIG - Q3 2005 Signet Group Earnings Conference Call

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CONFERENCE CALL PARTICIPANTS

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Lehman Brothers - Analyst

Jeff Stein

KeyBanc Capital Markets - Analyst

John Baillie

Société Générale - Analyst

PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to today's Signet Group quarter three results conference call. For your information, today's call is being recorded. At this time I would like to turn the call over to your hosts today, Mr. Terry Burman and Mr. Walker Boyd. Please go ahead, gentlemen.

Terry Burman - Signet Group - CEO

Welcome to the conference call on Signet's third quarter results. I'm Terry Burman, Group Chief Executive speaking from Akron, Ohio. Joining the call from London are Walker Boyd, Group Finance Director and Tim Jackson, Investor Relations Director. Walker will discuss the financials and then I will cover the U.S. and UK operations. We will then open the call to questions. Before we begin, Tim will give the Safe Harbor statement.

Tim Jackson - Signet Group - IR Director

This call, including the questions and answers, may contain 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, that appear in a number of places throughout this call. They include statements regarding, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the industry in which the company operates.

The forward-looking statements are not guarantees of future performance and are subject to a number of risks and uncertainties which are more fully described in the Company's earnings release dated 22nd of November, 2005 and in the Risk and Other Factors Section of the Company's 2004/05 Annual Report on form 20-F filed with the U.S. Securities and Exchange Commission on the 3rd of May, 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 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 to reflect subsequent events or circumstances. Additionally, certain financial information used during the call are considered to be non-GAAP financial measures. For a reconciliation of these to the most directly comparable GAAP financial measures, please

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refer to the company's earning release dated the 22nd of November, 2005 available on the financial information section of the Company's website at www.signetgroupplc.com.

Terry Burman - Signet Group - CEO

Thank you, Tim. Walker will now review the numbers.

Walker Boyd - Signet Group - Group Finance Director

Thanks, Terry. I would remind everyone first of all, we are now reporting under IFRS and the comparative figures have therefore been restated. Looking first at the quarter: Group sales increased by 5.7%, as reported, and were up 5.5% at constant exchange rates. Like for like sales were up 1.8%. The third quarter is the smallest of the year, accounting for about 18% of annual sales.

Group operating profit was £5.5 million against £9.9 million last year. Financing costs of £2.5 million showed a further reduction, resulting in group pretax profit of £3 million against £7 million last year. The third quarter is traditionally a period of low profitability and the decline in results should therefore have relatively little impact on the year as a whole.

Turning briefly to the figures for the nine months: Total sales were up 5.7% on a reported basis and by 6.5% at constant exchange rates. The average exchange rate for the year-to-date being \$1.84 against \$1.82 last year. Group like for like sales were up 2.9%; the U.S. increasing by 7.6%, and the UK declining by 7.9%. Group operating profit for the nine months was 61 million pounds, down 5.6% on a reported basis and by 4.7% at constant exchange rates. The group operating margin was 5.9% against 6.6 in the comparable period last year, reflecting trading in the UK.

Net interest payable was £5.9 million, down £1.7 million as a result of lower average net debt levels. Group profit before tax was only slightly below last year's level at £55.1 million against £57 million for the nine months. The year-to-date tax rate was 34.5% as anticipated, and down on last year's rate of 37%. Basic EPS were unchanged at 2.1p.

Looking at the balance sheet: Net debt at the end of the quarter was 217.9 million pounds against £192.6 million a year ago. The seasonal increase in net debt resulting from cash flows in the year-to-date was £121.2 million before exchange differences of £13.2 million. This was £7.4 million more than last year and reflected timing differences on merchandise receipts and higher tax and dividend payments, partially offset by receipts from the sale of our offices in Colindale in North London.

With regard to capital spend, we continue to expect group expenditure to be around £85 million for the year, about £15 million ahead of last year. We remain on track to be broadly cash neutral for the year. I'll now hand back to Terry.

Terry Burman - Signet Group - CEO

Thank you, Walker. I'll now review the group's operations beginning with the U.S.

Sales for the quarter increased by 12.1% on a reported basis and by 11.8% at constant exchange rates to 220 million pounds. Our like for like sales were up by 6.6%, with the less-strong growth in the latter two months of the period reflecting a similar reduction in the rate of growth of both Jared and the mall store brands. The mall brands' like for like performance was solid and Jared continues to perform very well. Overall there was a further gain in market share driven by both like for like sales and space growth.

The average transaction value continued to rise and is up about 12% in the year-to-date. The increase was about 10% in both the mall brands and Jared. This was due to changes in merchandising mix where we have been successful in meeting customer demand for higher-priced items, such as loose diamonds and luxury watches in Jared, as well as selective price increases implemented earlier in the year.

The net impact of these factors, together with commodity cost increases and supply chain improvements, meant gross margin was down for the third quarter. The impact in the 4th quarter is expected to be similar. As a result, gross margin for the year is now expected to be down by 40 to 60 basis points, rather than the 20 to 40 basis points indicated earlier in the year.

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While hurricanes are a part of doing business in the southeast and Gulf Coast states, the impact of Katrina was exceptional. As a result, we are projecting up to 3 million pounds of potential uninsured losses.

U.S. Q3 operating profit rose to 9.5 million pounds, and reflects an 18.3% increase in constant currency terms. As Walker mentioned earlier, this is a low quarter in terms of sales, only accounting for about 18% of the annual U.S. total, reflecting a lack of any major events and a low level of marketing activity. In the year-to-date, U.S. like for like sales were up 7.6% and total sales increased by 12.4% at constant exchange rates.

US operating profit for the nine months was with 70.6 million pounds, an increase of 19.3% at constant exchange rates and 18.1% on a reported basis. The operating margin for the nine months was 9.3%, versus 8.8% last year reflecting the leverage of strong like for like sales combined with continued tight control of costs. The bad debt charge for the nine months was 3.2% of total U.S. sales against 2.9% in the comparable period and was comfortably within the range of recent years. This movement partially reflects an increase of approximately 1% in the level of credit participation with the slightly higher bad debt charge offset by higher receivables income.

Our real estate investment in 51 new mall stores and 72 refurbishments and relocations is substantially completed. The number of mall store closures is anticipated to be 13, slightly below normal even after including 3 stores that are anticipated to remain closed at year end due to Hurricane Katrina. As we indicated at the interims, we intend to open Kay stores in 11 off-mall and 3 metropolitan locations this year.

18 Jared stores are planned to be opened this year; however, one Jared in New Orleans will be closed into next year. At year end we anticipate that there will be 110 Jared stores trading, equivalent in space terms to about 450 mall stores. Jared is trading better than anticipated, benefiting from the introduction of TV advertising and merchandising initiatives such as the development of the luxury watch category.

In advertising, Kay's superior relative sales growth means TV impressions will again increase this holiday season, reinforcing its industry leading position without spending more on marketing as a proportion of sales. The commercials that we are introducing this year continue the highly successful 'Every Kiss Begins with Kay' execution and have performed extremely well in our consumer research. The TV spend will again be supported by national radio and press advertising. Local radio advertising impressions for the regional brands have been maintained and a television campaign is being tested in one JB Robinson market. The level of local television advertising support for Jared during Christmas is again being increased and will cover 100% of sales for the first time. Overall, marketing spend for the year as a proportion of sales is expected to be slightly up on last year, reflecting the increase in sales mix coming from Jared.

We have a number of merchandising initiatives in place for this Christmas. For example the Leo, loose and solitaire diamond ranges have been further developed, we also have expanded the test of the enhanced diamond offering in Kay and the fashion gold assortment has been increased. Jared continues to build its offering and reputation in the luxury watch market. Training this year has been at record levels. All of these programs further our ability to lift the average transaction price.

In summary, the U.S. business consistent with our culture of continuous improvement, has taken steps to ensure that we are able to execute this Christmas better than last year in the key retailing disciplines. We are well positioned to compete.

Turning now to the UK: Against the background of difficult trading conditions like for like sales were down 8.1% for the quarter, with total sales decreasing by 7.1% to £90.5 million. Reflecting the decline in like for like sales there was an operating loss of 2.5 million pounds compared to a profit of £3.7 million last year. For the year-to-date UK like for like sales decreased by 7.9%, and total sales by 7.1% to 273.8 million pounds. The operating loss was 4.9 million pounds against a profit of £9.7 million last year, although merchandise margins were above last year's level.

The diamond mix and the average transaction value in both H. Samuel and Ernest Jones continued to increase with footfall remaining the issue. The number of transactions is down, but anecdotal evidence continues to suggest that we are at least maintaining market share.

In real estate, 75 stores predominantly H. Samuel will be refurbished or relocated this year. The program was virtually completed by the end of the third quarter. In total, 227 stores covering over 40% of sales will be in the new format this Christmas. These stores continue to achieve the necessary sales uplift compared to their peers. We will open seven stores this year, two H. Samuel and five Ernest Jones. In line with our real estate strategy, 14 H. Samuel and one Ernest Jones will be closed.

Enhancements in the diamond collection and its presentation continue to be made. The Leo and Forever diamond ranges have been further expanded, as has the white metal selection. We will also be stocking a limited number of key items which will be promoted to help drive footfall. Drawing on our experience in the U.S., there will be fewer such items than last year but the focus and quantities will be greater.

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The commission system continues to be expanded across the store base and has been well received by staff. Again, its structure draws on our U.S. experience and is designed to reward both team and individual performance, to reinforce a selling culture and to attract and retain the best people.

Television advertising coverage for both H. Samuel and Ernest Jones will be similar to last year. For H. Samuel ads will run in markets representing about 65% of sales and for Ernest Jones the figure is about 60%. New creative executions have been developed for both brands. Marketing as a proportion of sales will be up from last year.

For the first time, H. Samuel will have an e-commerce capability this Christmas. So far, the performance of this initiative is meeting our expectations, although it is too early to judge its success.

In conclusion, Group profit before tax in the nine months to date was only slightly below that of last year. Our U.S. division performed extremely well but the UK business experienced difficult trading conditions throughout the period. Our businesses are in good shape and are well placed to compete. As always, results for the year as a whole will be dependent on the outcome during the all important fourth quarter which represents some 40% of annual sales.

Now, I'd like to open the call to take your questions, however, please note that we will not comment on trading in November or on the outlook for the holiday season. Operator?

QUESTION AND ANSWER

Operator

Thank you, Mr. Burman. [OPERATOR INSTRUCTIONS]. We will now take our first question from Allegra Piaggi from Lehman Brothers. Please go ahead.

Allegra Piaggi - Lehman Brothers - Analyst

Yes, hello. I just have a few quick questions, please. The first one, have you introduced any new measures ahead of Christmas in recent months in light of continued weak trading in the UK? Can you comment a little around how your initiatives compare to last year?

Secondly, what proportion of demand in the fourth quarter is in bridal and what proportion is gift driven over Christmas, and how does this compare to other quarters of the year? And lastly, if I may, third question, what are your views on commodity price inflation next year and how are you positioned with your hedging for next year as it stands now?

Terry Burman - Signet Group - CEO

Okay. Let's see. In terms of measures in Christmas in the UK, we started the e-commerce site as we mentioned, and as I also mentioned in my comments, we have changed our promotional activity to be -- to reflect a tactic that we use in the U.S., which is a very narrow and deep promotion on few items. We have continued all year to increase our training of our people, and they are better trained and at a higher level than they have been in the past. We have continued to convert to our higher proportion of diamond sales. We have continued our revamp of the stores, and as I said there were over 70 stores that have been converted to the new millennium format.

Some measures continue our strategy, which we know is working, because the -- because the average transaction continues to increase, average transaction value in the UK continues to increase and the diamond mix continues to increase. And that is in both H. Samuel and Ernest Jones.

The issue really is about footfall and I think it is one that most UK retailers, most if not all of UK retailers are experiencing right now. But we know we have got a good strategy. We are continuing to implement it with a couple nuance changes as I mentioned.

In terms of the proportion of bridal versus gift, talking about U.S., UK or both divisions?

Allegra Piaggi - Lehman Brothers - Analyst

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Both, please.

Terry Burman - Signet Group - CEO

The proportion of bridal in the U.S. on a year-round basis is a little over 40%. And I don't have the numbers handy, but it -- it -- we're talking U.S. now, it does decrease somewhat and shift to more gift giving type of merchandise in the fourth quarter. And the gift giving becomes a greater proportion of the sales as you get closer to Christmas. I don't have the number handy Allegra but if you would like to contact Tim he would be happy to get that number for you.

In terms of the U K, a much lower proportion of our sales, as you know, is in bridal but it is my understanding that the -- that the same trend occurs as you get -- as you get closer to Christmas it becomes more of a gift giving than a bridal. Having said that, the fourth quarter, because of the weight of its volume, is our biggest quarter for bridal merchandise.

Allegra Piaggi - Lehman Brothers - Analyst

Yes.

Terry Burman - Signet Group - CEO

In terms of commodity costs, commodity outlook, in terms of diamonds, they have, the increases are continuing but they are continuing at a -- at a very moderated rate. So mid single digits is -- is the rate at which they are increasing now, and I'm talking about polished. I'm not talking about rough. Will that continue into next year? I'm not going to -- I'm not going to speculate on that. I'm just telling you that what is occurring.

In terms of gold, we all see that gold is up above \$490 today. And platinum is pushing \$1000 and certainly gold is much more important to us as a percentage of our cost to goods sold. There is speculation that one reads in the market -- in the press about the gold prices spiking because of high jewelry demand and because of some people I have read about some people, it is speculated some people are covering shorts in gold and you read the opposite, you read that gold is going to hit \$500 and go above it. Again, I'm not going to speculate on this, but clearly, at this level of gold price it will put additional pressure on our margins.

Walker, do you want to comment on our hedging?

Walker Boyd - Signet Group - Group Finance Director

Yeah, I think our hedging in terms of commodity pricing specifically on gold for next year is at the minute at a relatively low position as it would tend to be at this time of the year where we take a view in terms of our budgeted end costs. On the other hand, our hedging position in the UK for currency requirements, we are probably proportionately more hedged than normally, so I think net in net we are probably about the same level overall hedging as we would be at this time of year for the forthcoming year.

Allegra Piaggi - Lehman Brothers - Analyst

Thank you.

Terry Burman - Signet Group - CEO

Does that answer all your questions?

Allegra Piaggi - Lehman Brothers - Analyst

Yes, yes, very much. Thank you very much.

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Terry Burman - Signet Group - CEO

You're welcome.

Operator

[OPERATOR INSTRUCTIONS]. We will now move to our next question from Mr. Jeff Stein of KeyBanc Capital Markets. Please go ahead.

Jeff Stein - KeyBanc Capital Markets - Analyst

Terry, wonder if you might mind commenting on what the average dollar transaction was at Kay during the quarter and also at Jared relative to the prior year?

Terry Burman - Signet Group - CEO

They were both up about -- you're talking about just for the quarter, Jeff?

Jeff Stein - KeyBanc Capital Markets - Analyst

Yes, and looking for a dollar amount as opposed to the percentage that you cited. And then secondly, if you can just talk a little bit about how much of the percentage increase that you saw at both of those businesses was the result of mixing up versus raising selling prices.

Terry Burman - Signet Group - CEO

That a difficult thing to get your arms around, what with introducing new merchandise ranges, but I would -- we -- we -- we estimate that the increase is about half and half. Increase in selling prices and just an increase in merchandise initiatives. You know, I don't have the average transaction price, the absolute dollar amount for the quarter. Do you have that, Tim?

Walker Boyd - Signet Group - Group Finance Director

It is Walker here. For the year-to-date which is probably a more accurate, a more meaningful number in the mall business the average transaction was about \$310. And for Jared it is about \$720. And both of these, as Terry said, for the year-to-date are about 10% higher than the corresponding number for last year first nine months.

Jeff Stein - KeyBanc Capital Markets - Analyst

Okay. And then final question. Could you talk a little bit and discuss your internet strategy that you might have today and in the future for the U.S. market?

Terry Burman - Signet Group - CEO

Sure. We have -- as you know, Jeff, we have avoided e-commerce for the -- to date for the years to date, that e-commerce has been in existence and for us it was simply a matter of the market wasn't large enough for us to, even with our projected share, which we would expect would be substantial, to be able to earn a profit. The total e-commerce market has grown sufficiently now that it is -- that it certainly will be sooner rather than later that we actually enable our e-commerce site. So it will be in the not-too-distant-future that we will be looking to go live one-commerce. The first brand that we would bring on toe-commerce would be Kay, and then the next brand would be our next biggest brand which would be Jared. So that would be the order that we would go live in terms of e-commerce.

Jeff Stein - KeyBanc Capital Markets - Analyst

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Okay. Thank you.

Terry Burman - Signet Group - CEO

You're welcome.

Operator

We will now take our next question from Mr. John Baillie of Société Générale. Please go ahead.

John Baillie - Société Générale - Analyst

Good afternoon, or good morning, gentlemen. On space expansion, do you feel that looking forward, that you can move above the 9% level, that you can actually manage a greater rate of space expansion and getting some feel for how that will split between Jareds and the mall stores and the more recent trials.

Terry Burman - Signet Group - CEO

The quick answer to your question, John, is yes we could handle a greater rate of space expansion but as you have seen us, we tend to edge it up year-by-year as opposed to take a leap. And that is in order to -- for us to build our infrastructure, our central infrastructure to be able to support that expansion and most importantly, ensure that the quality of our existing operations continue to improve. So, yes, we could handle a faster rate of space growth, but if we -- if we edge it up, if we move it up it will be in small increments.

John Baillie - Société Générale - Analyst

Are you finding it easier to be offered more appropriate sites now with obviously the problems elsewhere in the sub sector and is it -- do you find that the quality of space is improving?

Terry Burman - Signet Group - CEO

Well, let's see. There is -- there are a lot of new off-mall formats. We have, as we flagged at the half year, we have proven now our off-mall format both in power centers and in lifestyle centers and we continue to expand. We will continue to expand in -- in those formats and lifestyles and power, the off-mall formats are two of the fastest growing, in terms of real estate development in the U.S.

The metro stores, we have two open. We have got one opening this week - a second one in New York City on Fulton street in Brooklyn, so we will have three opened by the end of the year, and those three opened since June, so we are just in the initial phases of that, but we do expect that to be a component of our expansion strategy.

The malls are -- there are very few malls being built. Low single digit anticipated for the next several years in terms of mall -- enclosed regional malls. And in terms of their development, very few. However, because there are several troubled national or super-regional jewelers, we are finding that we're having no difficulty in finding quality space available to us. The space -- there is a lot more offered to us than we accept. And, however, as we said we'll be opening about 50 -- 51 mall stores this year. So obviously we are finding space that meets our site selection criteria.

John Baillie - Société Générale - Analyst

And is the price coming down?

Terry Burman - Signet Group - CEO

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Well, I wouldn't like to comment openly about the kind of prices that -- that is really proprietary in terms of the kind of prices that we are paying for space.

John Baillie - Société Générale - Analyst

Okay. Thank you.

Terry Burman - Signet Group - CEO

You're welcome.

Operator

[OPERATOR INSTRUCTIONS]. We have a follow-up question from Allegra Piaggi from Lehman Brothers. Please go ahead.

Allegra Piaggi - Lehman Brothers - Analyst

Hi, I just wanted to ask a little bit more about around the H. Samuel e-commerce site that you launched earlier in quarter. There has been a lot of press about the expected surge in internet sales over Christmas. I just wanted to get a feel where you see an outperformance of the e-commerce site relative to the stores, and also to get a feel around the price -- if there is a price differential relative to the stores, and whether you are featuring any internet only specials to kind of spur demand there?

Terry Burman - Signet Group - CEO

No, we have got -- we have got -- no, we are not doing anything internet special. And our prices will be consistent with our store-offered prices. The advantage that we have in e-commerce is our strong brand and the affiliation with our bricks and mortar stores, but we certainly wouldn't want to do anything to undermine our bricks and mortar stores by activity on e-commerce. So they -- they work -- really e commerce is another opportunity for our customers to shop with us and utilize our bricks and mortar stores to get the merchandise serviced. That is how we approach e commerce. In terms of its performance, at the current time, we are -- it is -- the site's only been live for a couple of months now. And is meeting our expectations.

Allegra Piaggi - Lehman Brothers - Analyst

Thank you.

Operator

It appears we no further questions at this time. Mr. Burman, I like to turn the conference back over to you for any additional or closing remark.

Terry Burman - Signet Group - CEO

Thank you, Operator. And thank you all for taking part in this call. Our Christmas trading statement is scheduled for January 12th next year, and it will be followed by a conference call. Thank you again for participating. Goodbye.

Operator

That will conclude today's conference call. Thank you for your participation. You may now disconnect.

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