Conference Call Transcript

SIG - Signet Group Christmas Trading Statement Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Signet Group Christmas Trading Statement conference call. For your information, this conference is being recorded. At this time, I would like to turn the call over to your host today, Mr. Terry Burman. Please go ahead, sir.

Terry Burman *- Signet Group - Group Chief Executive*

Thank you, operator, and welcome to the conference call on Signet's Christmas Trading Statement. I am Terry Burman, Group Chief Executive and I have with me Walker Boyd, Group Finance Director and Tim Jackson, IR Director. I will comment on the Group's performance and then we will be available for questions. But first, I would like to ask Tim to 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, and appear in a number of places throughout this call. 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 described in the Company's Christmas Trading Statement dated 12th of January, 2006, 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 3rd of May, 2005, and other filings made by the Company with the commission.

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Terry Burman *- Signet Group - Group Chief Executive*

Thank you Tim. I will start with a brief group overview. Like-for-like sales increased by 1.1% over the Christmas period with a solid performance by the U.S. business, offsetting the downturn in the U.K. division. In the same period, total sales were up by 11.7% on a reported basis and 4.8% at constant exchange rates. In the 48 weeks to 31 December 2005, like-for-like sales rose by 2.2%; total sales increased by 8.3% on a reported basis and by 5.8% at constant exchange rates. The exchange rate for the year is anticipated to be one pound to $1.80 against one pound to $1.86 last year.

Profit before tax for 2005/06 is currently expected to be within the range of market estimates and to fall between 193 and 199 million pounds. The Group's cash flow for the full year is expected to be broadly neutral and the balance sheet remains strong.

Turning to the detail of the Christmas trading period and starting with the U.S. In a solid retail environment, the business continued to benefit from the implementation of its proven strategy and culture of continuous improvement. The consumer faced higher fuel prices and increased interest rates, but these factors were balanced by a steadily improving jobs market.

In the nine-week period to 31 December 2005, U.S. like-for-like sales rose by 5.5% and total dollar sales increased by 10.5%, building on the growth record of the business. Once again we significantly outperformed the competition. The mall stores, which account for about 80% of the like-to-like store base made further progress, building on their industry-leading sales per store. Kay enhanced its position as the number one specialty jewelry brand in the U.S. Jared, our off-mall destination superstores, continued to trade particularly well. The 5.5% like-to-like sales growth compares with a 3.5% growth in year-on-year sales reported by the International Council of Shopping Centers for chain store sales in November and December.

Total sales at constant exchange rates rose by 10.5% and by 21.3% on a reported basis for the nine-week period. Looking at the holiday performance in more detail, customer service was once again critical to the successful performance, and a continued focus on staff training and development throughout the year proved beneficial. For example, the number of trained diamontologists in our stores this Christmas increased by about 500 compared to last year. In merchandising diamond fashion jewelry, the bridal and engagement categories and watches performed particularly well. During the nine-week period, the division's average unit selling price increased by about 7%, which was lower than the year-to-date trend of about 10%.

Our appreciation in romanced-based ‘Every Kiss Begins With Kay’ campaign continues to be very successful. The number of television and print impressions for Kay increased over the holiday season and was again supported by a national radio campaign and direct-mail advertising. For the regional brands, local radio advertising support was maintained and an initial test TV campaign for JB Robinson was carried out in the Cleveland area.

All Jared stores were covered by local television advertising, up from just over 90% in 2004. We now expect it to be economical to move to national TV advertising for Jared in Christmas 2007. The ratio of marketing spend to sales by brand was in line with last year, but is expected to be slightly up for the U.S. division as a whole in 2005/06 due to the growth of Jared.

This year, overall new store space will have increased by 9% from last year, comprised of 18 Jared stores, 49 mall stores, 11 Kay off-mall stores, and 3 metropolitan stores. We expect to close 15 mall stores in 2005/06 in line with last year, including three due to hurricane damage. One Jared in New Orleans remains closed, but we expect it to reopen in the first half of next year. It is anticipated that in 2006 our new store space increase will be between 8% and 10%.

As indicated in November, the gross margin is anticipated to have declined over the holiday period. This reflected commodity cost increases and mix changes partly offset by action on prices and supply chain initiatives. In December we announced a rough diamond sourcing and manufacturing initiative designed to secure additional reliable and consistent supplies of diamonds for our customers. Year-end inventories are anticipated to be in line with plan.

In the 48 weeks to 31 December 2005, U.S. like-to-like sales increased by 6.8%, with total sales up 11.7% at constant exchange rates and by 15.4% on a reported basis.

Credit sales participation for the year is expected to be up a little on last year. The bad debt percentage to total sales for the year is expected to be broadly in line with the average of recent years. It is likely to be about 30 basis points up on the low level of last year due to the increased participation and a temporary up tick in bankruptcies ahead of the new law which became effective in October.

The U.S. divisional operating profit is anticipated to be comfortably ahead for the year as a whole.

Now turning to the U.K. business, in the U.K. the trading environment showed no improvement during the Christmas period and like-to-like sales decreased by 9.3%; the performance of H.Samuel and Ernest Jones being similar. Pricing discipline was maintained and the gross margin is a little ahead of last year. Inventory is as planned.

The dominant feature in the U.K. was the difficult trading conditions experienced during the Christmas period. We believe this to be particularly true for higher priced, more discretionary items. This reflects the pressure on consumer expenditure from factors such as higher interest rates, energy price increases, and various forms of taxes. Unfortunately, hard-line data for the performance of the U.K. jewelry sector is not available, but there is some evidence that suggests that we have performed at least in line with other jewelers.

The average selling price and diamond participation increased further, in line with our strategy. In H.Samuel the average selling price was up 3.2% compared to last Christmas, and diamond participation rose by 100 basis points, with the Forever Diamond range performing very well. In Ernest Jones the average selling price increased by 4.3%, but diamond participation was down by 80 basis points over Christmas, however is up for the year-to-date by 40 basis points. Within the diamond category, the Leo range performed well.

The focus remains on customer service and product knowledge. Continued training of store staff is a priority. This Christmas all store staff were on a commission basis, which was very well received. 227 stores accounting for over 40% of U.K. sales, traded in the revised store format compared to 142 last year. These were mostly H.Samuel stores and relative outperformance of the refurbished units was maintained. In 2006/07 the refurbishment cycle means that the number of stores due for a refit is reduced.

This Christmas we maintained the coverage of TV advertising at about 65% for H.Samuel and 60% for Ernest Jones. We evolved the creative work in 2005 and expect to do the same in 2006. For the year-to-date, the U.K. jewelry division like-for-like sales declined by 8.4% and total sales by 7.6%. On a like-for-like basis, H.Samuel's sales were down 8.9% and Ernest Jones by 7.8%.

While U.K. operating profits will be substantially down this year, the business continues to achieve a healthy operating margin and return on capital.

It was announced earlier today that Mark Light has been appointed a Director of Signet and Chief Executive of its U.S. operations. Mark has been Chief Operating Officer of the U.S. for the last three years and has worked in the business for over 20 years. In that time he has gained wide experience in many areas of the business including store operations, merchandising, marketing and real estate. I will remain as Executive Chairman of the U.S. division. This means that while I will be taking a step back from the day-to-day running of the U.S. business, I will continue to be involved in the strategic development and oversight of the division.

In conclusion, the trends that we saw in the third quarter largely continued. Our well-established operating strategies in both the U.S. and the U.K. remain in place. As I said earlier, profit before tax for 2005/06 is currently expected to be within the range of market estimates and to fall between 193 million to 199 million pounds. And now I would like to open the call to any questions that you may have.

QUESTION AND ANSWER

Operator

(OPERATOR INSTRUCTIONS). Jamie Isenwater, Deutsche Bank.

Jamie Isenwater *- Deutsche Bank - Analyst*

Good afternoon, gentlemen. I just had a question about capacity issues. Obviously it has been a benefit to you in the U.S. for the second half of this year and likely to continue to next year. Is there any sign that you can benefit to a similar degree in the U.K. going forward given how tough 2005 has been and how difficult Christmas was in particular?

Walker Boyd *- Signet Group - Group Finance Director*

Sorry, Jamie, you mean in industry capacity? You mean in terms of the number of jewelry stores, decline in the number of jewelry stores?

Jamie Isenwater *- Deutsche Bank - Analyst*

Exactly, yes.

Terry Burman *- Signet Group - Group Chief Executive*

Well as you know, Jamie, the U.S. jewelry industry has been consolidating. It's been a trend that has been going on for over a decade and I do believe that we have benefited from that and I would expect that there should be some consolidation of the U.K. industry that occurs. We got some wind of that today with the -- there was an article in the Daily Mail that Half Price Jewellers was in administration and that is an 80 store chain. So I would expect -- this is a normal cleansing cycle in the retail industry that occurs in all sectors. And I would expect some fallout from it.

Operator

Allegra Piaggi, Lehman Brothers.

Allegra Piaggi *- Lehman Brothers - Analyst*

Allegra Piaggi from Lehman Brothers. I was wondering if you could elaborate a bit on the expected benefit from the new supply chain initiatives you announced back in December and how you expect that to offset the increasing commodity prices that we have seen most notably at the end of last year please?

Terry Burman *- Signet Group - Group Chief Executive*

Sure, Allegra. The initiative that we announced in December, which was to begin sourcing and manufacturing rough diamonds into polished, is in its initial startup phase and as we do with any new program, we will be testing it and feeling our way through it before we get into it in great depth. So we would expect -- the reason for this initiative is to guarantee us -- to better guarantee us a more consistent supply and price of our diamond needs. And as we grow, that becomes a more important factor for us. We would also hope to gain some benefit on the pricing side but that is still -- all of these issues are yet to be determined. But as diamond consumption has grown over the last five years by about 5% a year and diamond production is growing by about 1% a year, we think it is more and more important that we take measures to guarantee ourselves consistent supplies and consistent pricing and that is our primary motivation for entering this stage of the supply chain.

Operator

James Pan, CPE Partners.

James Pan *- CPE Partners - Analyst*

I have a couple of quick questions on your U.K. market. You said it was relatively flat. How does it compare to I guess five years ago? I guess that is one cycle. And typically how much marketshare do you guys pick up when you see a situation like this that you have seen in the U.K. where there is a shakeout and things like that? Two to three years from now, how much marketshare do you think you'll be able to grab or take advantage of the situation going on in the U.K. right now I guess is the question? Thank you.

Terry Burman - ***Signet Group - Group Chief Executive***

The marketshare data is not as robust in the U.K. as it is in the U.S. From the information that we have, we believe we have about a 17% marketshare and that's been similar over the last several years. I don't think that there is any way we can determine how much share we are going to pick up, if any at all, in this kind of environment. Although I would expect to be able to pick up some share. But our strong balance sheet, our high level of profit allow us to continue to invest in our business, which we plan on doing. We'll continue to invest in training our people, improving our merchandise ranges, emphasizing diamonds, improving the store environment and developing advertising that is going to drive consumers into our stores.

One would expect logically that with the ability to continue developing our business again because of our strong balance sheet and our healthy level of profit that we should be able to gain some marketshare. But I would be reluctant -- I just wouldn't put a number on it.

James Pan - ***CPE Partners - Analyst***

Okay. A quick follow-up to that. If that is going on in the United States right now, how come you don't think it has happened in the U.K. yet? Even though a more volatile market, you would think with all those advantages you have you would start pulling away from the competition?

Terry Burman - ***Signet Group - Group Chief Executive***

As I said, the market statistics here are much less robust than they are in the U.K. It is just more difficult to determine our exact marketshare and if it is really growing or not. But there is also very little space growth going on in the U.K. versus the U.S. And that could -- that has probably got something to do with the comparative lower marketshare gains.

Operator

James Targett, Goldman Sachs.

James Targett - ***Goldman Sachs - Analyst***

I just wondered if you could maybe talk a little bit about the gross margin outlook in the U.S. for next year, in calendar year 2006. And particularly if you're expecting a similar level of decline in the U.S. and what might be the sort of the mix of that between rising commodity prices and the increased contribution of Jared?

Terry Burman - ***Signet Group - Group Chief Executive***

While gold prices, especially over the last 30 or 45 days, have spiked up about 10%, diamond prices seem to have stabilized recently. So gold being a lower -- gold is a lower component of our total cost of goods sold than our diamonds. So we do have this increase in commodity prices that we will have to deal with, especially gold. But we don't -- I would call your attention to the fact that we are not seeing that kind of lift in the diamond prices. So we are not currently getting the pressure from that commodity.

We have, as in the past, a program for addressing commodity price increases, which include continued supply chain initiatives and some price increases. We will be evaluating commodity prices and competitors' prices to gauge the opportunity to further increase prices should gold prices hold at this -- gold and platinum prices hold at this level after the Valentine's Day period.

James Targett - ***Goldman Sachs - Analyst***

If you look of the outlook at the moment, the most movement in gross margin for next year in the U.S. is going to come from a change in mix, do you think?

Terry Burman - ***Signet Group - Group Chief Executive***

That has actually been the case over the last several years and continues to be the case. But as you have seen, our operating margins are remaining right around that 13% level. So we are getting some leverage from our sales base, especially in a year like this where we have got close to a 7% comp store sales increase going. And our growth helps us also leverage our cost base. So you have got offsetting issues there and a lot of that growth is coming from Jared and that is part of the reason that the mix is changing.

So there's a lot of moving parts here and while we are -- while we always focus on each element of our P&L and gross margin is a significant element, there are a lot of moving parts and we need to balance all of those and their total effect on our operating margin.

James Targett - ***Goldman Sachs - Analyst***

Well moving on to operating margin, it doesn't like we're moving to a softer period for U.S. consumers and the U.S. retail market generally. How comfortable do you feel with your operating margins and the U.S. next year and are you kind of bracing yourself for a weaker consumer and are you taking any cost actions regarding costs to prepare yourself for that?

Terry Burman - ***Signet Group - Group Chief Executive***

Well we always tightly control our costs but we are not going to take any -- we don't believe it is appropriate to take any unusual steps in terms of cost. We will, as always, try and keep them in line with our sales and our sales growth. But if you look at our sales trend, as we said in the third quarter that we had come out of the third quarter in the last two months, which would be September and October, with mid single digit like-for-like increases. Obviously during the Christmas period, November and December, we were again in mid single digit territory with a 5.5% like-for-like. So that seems to be our current run rate or that obviously is our current run rate and we are basing our plans and our decisions about growth, about costs and about sales expectations based on our current trends.

James Targett - ***Goldman Sachs - Analyst***

For the moment you're not unduly concerned about operating margins in the U.S. for fiscal year 2007?

Terry Burman - ***Signet Group - Group Chief Executive***

At the moment -- I'm sorry. I didn't catch that, James.

James Targett - ***Goldman Sachs - Analyst***

At the moment, you're not unduly concerned about operating margins in the U.S. for fiscal year 2007?

Terry Burman - ***Signet Group - Group Chief Executive***

That's correct. We believe that we are not looking for -- we are looking for a stable consumer environment.

Operator

David Jeary, Credit Suisse First Boston.

David Jeary - ***Credit Suisse First Boston - Analyst***

I just had one question, one clarification on a number I missed if that is all right. The number I missed if you wouldn't mind repeating it is the number of stores in the refurb and the percent of sales they accounted for in the U.K. The second question is also related to U.K. It is why you believe the diamond participation in Ernest Jones declined over Christmas.

Terry Burman *- Signet Group - Group Chief Executive*

The number of stores in the refurb is about --.

Walker Boyd *- Signet Group - Group Finance Director*

Over Christmas, it was over 200. It was 227, which represents about 40% of U.K. sales.

David Jeary *- Credit Suisse First Boston - Analyst*

Thanks, Walker.

Tim Jackson *- Signet Group - IR Director*

Diamond participation in EJ.

Terry Burman *- Signet Group - Group Chief Executive*

Diamond participation in EJ. We have identified the categories that were weaker and we're still sorting through trying to determine for ourselves why it was -- why it was weaker over the Christmas period. Although I will say that -- I would remind you that it has been up for the -- that it is up for the year as a whole in both divisions, Ernest Jones and H.Samuel.

David Jeary *- Credit Suisse First Boston - Analyst*

It sounds like you're not prepared to say at this stage or unwilling what those categories were?

Terry Burman *- Signet Group - Group Chief Executive*

I'm sorry. Say that again, David.

David Jeary *- Credit Suisse First Boston - Analyst*

It sounds like you are unwilling to say what those categories were at this stage.

Terry Burman *- Signet Group - Group Chief Executive*

Yes, we don't like to talk about our specific -- what I'm telling you is that the fashion jewelry was an issue. It also could have been driven by -- there could be some of it driven by in Ernest Jones, watches, particularly the luxury watches were strong.

David Jeary *- Credit Suisse First Boston - Analyst*

Do you have the year-to-date increase in diamond participation at H.Samuel? You said it was up 100 bpts over Christmas. I wonder what is the run rate in terms of the full year to comp with the 40bpts that EJ is.

Terry Burman - ***Signet Group - Group Chief Executive***

In H.Samuel, for the full year is also 1%.

Operator

Sundeep Bahanda, Deutsche Bank.

Sundeep Bahanda - ***Deutsche Bank - Analyst***

Terry, I have a question for you on the U.S.

Terry Burman - ***Signet Group - Group Chief Executive***

Sure, Sundeep.

Sundeep Bahanda - ***Deutsche Bank - Analyst***

You have demonstrated quarter-on-quarter, year-on-year that you manage to outperform the competition. You talk about in the statement today that Jared in particular has been trading very well. You mentioned the state of the competition early on. Why aren't you more aggressive in the U.S. and take advantage of the current situation? If you look at arguably based on [retail], (indiscernible), when the time is right, (indiscernible) more (indiscernible) is the right time to actually accelerate expansion in the U.S. or is there a particular constraint that has stopped you from doing that?

Terry Burman - ***Signet Group - Group Chief Executive***

Well in fact we are accelerating growth. Several years ago we were growing our new store space by about 6% to 8%. We moved that up to 7 to 9%. And for the coming year, we just announced that we are raising our target to 8 to 10%. We have also said that we would be willing to -- that we are prepared to do an acquisition, right real estate, right location, right segment in the market if we can find an appropriate acquisition target.

So we are growing faster. We are growing space faster than any other jeweler out there. We are getting marketshare faster than anybody out there. I think we are growing at an appropriate pace.

Sundeep Bahanda - ***Deutsche Bank - Analyst***

(multiple speakers) double-digit step up? I mean is there a capital constraint or a people constraint (indiscernible) that will prevent you or is it just --?

Terry Burman - ***Signet Group - Group Chief Executive***

Well, it is kind of a combination of everything, including your operation disciplines. History is filled with retailers who have accelerated their expansion too fast and that can be a perilous -- that can be a perilous thing to do and we have increased our expansion at a measured pace because it allows our infrastructure to keep up with the rate of that growth. It also allows us to continue to improve the quality of our existing operations. We don't want to leave those stores behind because we are so focused on new store expansion.

So we think that this is an appropriate way to increase our marketshare and continue to maintain the quality of our existing operations without jeopardizing the quality of locations that we have, the quality of people that we bring in, the amount of training that we give all of those people. It's certainly not a money problem as you have seen. Our balance sheet has only strengthened as we have continued to expand. So it is certainly not a balance sheet issue.

Operator

(OPERATOR INSTRUCTIONS). John Baillie, Societe Generale.

John Baillie *- Societe Generale - Analyst*

Just wondering given the growth opportunities in the U.S. and the totally mature business in the U.K. that is just exposed to the cycle, what is your commitment to the U.K. and is there really any justification or benefits from retaining the U.K. if it could be exited at the right price?

Terry Burman *- Signet Group - Group Chief Executive*

Well I think the benefit for retaining the U.K. is healthy operating margins, healthy return on investment and strong cash flows. It's a good business. It's had a difficult year. That is obvious. But over the cycle, the business has performed very well and that is our objective is to perform well over the cycle. If you look at the U.K. business, the index Walker, Walker has done an analysis of the U.K. performance over the cycle that I would like him to share with you.

Walker Boyd *- Signet Group - Group Finance Director*

I think we acknowledge that the jewelry sector I think this Christmas has had a difficult time. We clearly have any other evidence that is available that confirms that. Taking it over a cycle and going back to 1999, if you index the nonfood BRC performance over that period of time again so U.K. jewelry has performed. Then despite the difficult year we have had this year, we still are significantly outperforming. So to come out of that cycle still without a healthy operating profit of probably somewhere in double-digits, return on capital in excess of 25% says we still have a good business. And we have the opportunity to continue to grow that through the diamond participation. And as Terry just said in response to the last question, I think it would be entirely wrong to say that there is a constraint on the U.S. growth because it is having to support the U.K. from a cash flow perspective. That is not the case. Therefore, we see no good reason why we shouldn't continue to keep the U.K. business within the Group.

John Baillie *- Societe Generale - Analyst*

Would you (indiscernible) at this stage, it's going to hold back the growth of the group in a sense that you have got a very strong growth machine in the U.S. with plenty of opportunities? The U.K. is in a static at 600 stores and (multiple speakers) cycle?

Walker Boyd *- Signet Group - Group Finance Director*

If you look back over that cycle, one could argue that -- well one would see in 2002/03, the growth of the U.K. business certain in terms of its operating margin and indeed cash flow was actually helping the growth of the group and to some extent complemented and somebody was talking earlier on about operating margins.

Clearly one of the constraints on the growth of the U.S. operating margin at the current time is the new space because clearly that new space to some extent is a drag on the growth of the U.S. operating margin. So again over the cycle with the U.K. with its high operational gearing has actually helped us. So I think it would be wrong to take a snapshot view of how the U.K. has performed this year in isolation as opposed to the level it has contributed to the development of the group over the last five years.

Terry Burman *- Signet Group - Group Chief Executive*

We wouldn't take a decision such as you are suggesting based on a one year performance.

John Baillie *- Societe Generale - Analyst*

No, but I accept that. Five years from now, I assume you don't take (indiscernible) of many more than 600 stores still and it is a mature business.

Terry Burman *- Signet Group - Group Chief Executive*

But we still see opportunity for growth within our store base. We still see the same opportunities for growth that we saw going into this year. Now it didn't occur this year. We have always said that we are subject to the general environment. We are not immune to it and we are not immune to it in the U.S. either. This kind of years occur. We are comforted by the progress we have made. We're going to continue investing in and developing the U.K. business because we think that there is opportunity there.

John Baillie *- Societe Generale - Analyst*

Thank you. Can I just ask on a separate issue? I did miss the start of the call but I'm not sure if you said anything about the uninsured losses from hurricane. Is there any clarity on that and are those reflected in the profit guidance of 193 to 199 million?

Walker Boyd *- Signet Group - Group Finance Director*

Yes. There are still great levels of -- high levels of degrees of uncertainty about exactly what the final loss will be. We gave indication, if you remember, John, at the end of Q3 somewhere in the 2 to 3 million pound range. I would suspect that it will still be within that range. I would probably say towards the lower end of that and yet these are accounted for in the range that we have talked about today.

Operator

(OPERATOR INSTRUCTIONS). Mr. Burman, it appears we have no further questions at this time. I would like to turn the call back over to you for any additional or closing remarks.

Terry Burman *- Signet Group - Group Chief Executive*

Thanks, operator. We would like to thank all of you for your participation in this call. Our next trading announcement will be the fourth-quarter sales, which is scheduled for February 2. And I would like to close by wishing all of you a happy new year.

Operator

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

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