Financial review

for the 53 weeks ended 3 February 2007

	2006/07 £m	**2006/07 %**	2005/06 £m	2005/06 %	2004/05 £m	2004/05 %
Sales						
US	**1,410.7**	**74.5**	1,282.7	73.2	1,107.8	68.6
UK	**482.5**	**25.5**	469.6	26.8	507.7	31.4
Total	**1,893.2**	**100.0**	1,752.3	100.0	1,615.5	100.0
Operating profit:						
US	**173.8**	**81.5**	167.1	83.4	142.4	69.8
UK	**55.0**	**25.8**	49.1	24.5	76.9	37.7
Group function	**(7.4)**	**(3.5)**	(8.0)	(4.0)	(6.8)	(3.3)
	221.4	**103.8**	208.2	103.9	212.5	104.2
Net finance charge	**(8.2)**	**(3.8)**	(7.8)	(3.9)	(8.6)	(4.2)
Profit before tax	**213.2**	**100.0**	200.4	100.0	203.9	100.0

Adoption of International Financial Reporting Standards

For financial years commencing on or after 1 January 2005 UK listed companies are required to report in accordance with International Financial Reporting Standards as adopted by the European Union, ("Adopted IFRS"). The Group therefore now prepares its results under Adopted IFRS. These results contain comparative information presented, where necessary, in accordance with Adopted IFRS. The most significant elements contributing to the change in reporting the presentation of financial information under Adopted IFRS, as compared to Historic UK GAAP, were the:

- inclusion of a charge for share-based payments;
- cessation of goodwill amortisation;
- timing of dividend recognition;
- disclosures relating to taxation; and
- treatment of leases.

These changes had no impact on the Group's historical or future net cash flow, the timing of cash received or the timing of payments.

Reporting currency

The reporting currency for the Annual Report & Accounts for the 53 weeks ended 3 February 2007 is pounds sterling. From the commencement of its next fiscal year on 4 February 2007, the Group will commence reporting in US dollars including comparatives and the five year record.

Introduction

The key drivers of operating profitability are the:

- rate of sales growth;
- balance between like for like sales growth and sales from new store space;
- achieved gross margin;
- level of cost increases experienced by the Group; and
- movements in the US dollar to pound sterling exchange rate, since the majority of the Group's profits are generated in the US and the Group has reported its results in pounds sterling for the 53 weeks ended 3 February 2007.

The gross margin percentage in retail jewellery is above the average for speciality retailers reflecting the slow inventory turn. The trend in gross margin depends on Signet's pricing policy, movements in the cost of merchandise sold, changes in sales mix and the direct cost of providing services such as repairs.

In general, gross margin percentage on gold jewellery is above that of diamond jewellery, whilst that of watches and gift products is normally below that of diamond jewellery. Within the diamond jewellery category the gross margin percentage varies depending on the proportion of the merchandise cost accounted for by the value of the diamonds; the greater the proportion, the lower the gross margin percentage. In addition, the gross margin in a Jared store is slightly below that of a mall store, although at maturity the store contribution percentage of a Jared store is similar to that of a mall store. A change in merchandise mix will therefore impact the Group's UK and US division's gross margin percentage and a change in the proportion of sales from Jared will impact the gross margin percentage of both the US division and Group. In the US division the growth of Jared and the increase in sales of higher value diamonds, both of which are helping to drive like for like sales growth, means that US gross margin percentage is expected to show a small decline each year.

The cost of goods sold used to arrive at gross profit takes into account all costs incurred in the purchase, processing and distribution of the merchandise and all costs directly incurred in the operation and support of the retail outlets. The classification of distribution and selling costs under Adopted IFRS varies from company to company and therefore the gross profit percentage may not be comparable from one company to another.

To maintain the operating profit margin, the Group needs to achieve like for like sales growth sufficient to offset any adverse movement in gross margin, the increase in operating costs (including the net bad debt charge) and the impact of immature selling space. Like for like sales growth above the level required to offset the factors outlined above, allows the Group to achieve leverage of its fixed cost base and improve operating margin; slower sales growth results in reduced operating margin. There are not any known trends or uncertainties in future rent or amortisation expenses that could materially affect operating results or cash flows.

Financial review (continued)

Signet's target of 8% – 10% new store space growth in the US, with a slight decline in space in the UK, means lower like for like sales growth is required in the UK than in the US to maintain operating margin. The increase in the planned new space growth in the US to 8% – 10% in 2006/07 from 6% – 8% in 2003/04, means that a faster rate of like for like sales growth is now required to maintain the US operating margin than has historically been the case. However, as new store space is anticipated to break even or to make a small contribution at the store level, the increase in the rate of growth is not expected to reduce overall profitability.

The impact on operating profit of sales variances (either adverse or favourable) is less in the US division than the UK, as certain variable expenses such as turnover-related rent and sales commission account for a higher proportion of costs in the US business than in the UK division. The impact on operating profit of a sharp increase or decrease in like for like sales performance is particularly marked.

A key factor in driving operating margin is the level of average sales per store, with higher productivity allowing leverage of expenses both in store and in central functions.

Movements in the US dollar to pound sterling exchange rate impact the reported results of the Group as the US division's results were translated into pounds sterling. Historically, a one cent movement in the exchange rate impacts profit before tax by some £0.8 million. From 5 February 2007 the functional currency of the parent company was changed to US dollars and the Group's reporting currency also changed to US dollars. Going forward, a one cent movement in the exchange rate impacts profit before tax by some $0.4 million. The Board believes it is currently inappropriate to hedge this exposure as the UK division's sales and costs are denominated in pounds sterling and the cash flow from the UK division is largely used to pay dividends to UK shareholders in pounds sterling.

53 weeks ended 3 February 2007

Total Group sales rose to £1,893.2 million (2005/06: £1,752.3 million), up by 8.0% on a reported basis and 11.5% at constant exchange rates (see page 32). On a 52 week basis Group like for like sales were up by 5.4% and net new store space contributed 4.5%. The 53rd week contributed 1.6% to sales in 2006/07 (see table opposite).

Group operating margin decreased to 11.7% (2005/06: 11.9%), reflecting a decline in the operating margin of the US division and an increase in that of the UK division (see table opposite). The 53rd week contributed some £1.8 million to operating profit in 2006/07. Group operating profit increased to £221.4 million (2005/06: £208.2 million), up by 6.3% on a reported basis and 10.1% at constant exchange rates (see page 32), as total sales growth more than compensated for the decline in operating margin.

Net financing costs amounted to £8.2 million (2005/06: £7.8 million), the increase being primarily due to the transition from a securitised borrowing facility to the new private placement note facility and incremental borrowing as a result of the share buyback programme offset by the movement in the US dollar/pound sterling exchange rate.

Group profit before tax increased to £213.2 million (2005/06: £200.4 million), up by 6.4% on a reported basis and 10.1% at constant exchange rates (see page 32). The 53rd week contributed some £1.5 million to profit before tax in 2006/07. Profit for the financial period increased by 8.2% to £141.5 million (2005/06: £130.8 million), an increase of 11.9% at constant exchange rates (see page 32). Earnings per share was 8.2p (2005/06: 7.5p), up by 9.3% on a reported basis and 12.3% at constant exchange rates (see page 32).

Sales

Components of 2006/07 sales growth

	US %	UK %	Group %
Like for like on a 52 week basis	7.0	1.1	5.4
Change in net new store space	6.2	0.1	4.5
Exchange translation	(4.9)	–	(3.5)
Impact of 53rd week	1.7	1.5	1.6
Total sales growth	10.0	2.7	8.0

US

Like for like sales for the US division increased by 7.0% on a 52 week basis, and total US dollar sales by 14.9%. The US division had a consistent performance throughout the year. The contribution from new store space was 6.2%, the impact of exchange rate movements was (4.9)% and the impact of the 53rd week was 1.7% (see table above). Total reported sales grew by 10.0%.

UK

The UK business saw sales stabilise in 2006/07 after a sharp deterioration in 2005/06. The strategy of increasing diamond participation continued to drive improvements in performance indicators such as average selling price, with the volume of transactions reduced. On a 52 week basis like for like sales increased by 1.1% and the impact of changes in net new store space was 0.1% and the 53rd week 1.5% (see table above). Total sales increased by 2.7%.

Operating profit

Operating margin movement

	US %	UK %	Group %
2005/06 margin	13.0	10.5	11.9
Gross margin	(0.7)	0.3	(0.5)
Expenses	0.7	0.4	0.7
New store space	(0.5)	–	(0.3)
Impact of 53rd week	(0.2)	0.2	(0.1)
2006/07 margin	12.3	11.4	11.7

US

The operating margin in the US division was 12.3% (2005/06: 13.0%). Leverage of 70 basis points from like for like sales growth partly offset the impact of additional immature space of 50 basis points as well as the adverse movement in gross margin percentage of 70 basis points and the impact of the 53rd week of 20 basis points (see table on previous page). Administrative expenses (see definition page 126) increased reflecting the resources required to support the growth of the division. The ratio of net bad debt to sales improved a little to 2.8% (2005/06: 3.0%). Operating profit was £173.8 million (2005/06: £167.1 million), up by 4.0% on a reported basis and 8.6% at constant exchange rates (see page 32). The commencement of television advertising for Valentine's Day 2007 in the last week of 2006/07, with the related sales benefit occurring in 2007/08, meant that the 53rd week did not contribute to operating profit.

UK

The division's gross margin increased by 30 basis points, the benefit from advantageous hedging positions and selective price increases more than offsetting higher commodity costs. The actions taken to reduce costs in 2005/06 benefited the business throughout 2006/07 and resulted in a 40 basis point improvement in operating margin (see table on previous page). Administrative costs in the UK were little changed due to cost savings implemented at the start of the year. The operating margin at 11.4% was up on last year (2005/06: 10.5%). Operating profit rose by 12.0% to £55.0 million (2004/05: £49.1 million). The impact of the 53rd week on operating profit was about £1.8 million.

Group costs

Group central costs amounted to £7.4 million (2005/06: £8.0 million, including a property provision of £0.7 million).

Taxation

The charge of £71.7 million (2005/06: £69.6 million) represents an effective tax rate of 33.6% (2005/06: 34.7%). The rate is lower than previously indicated due to the tax treatment of share options and the favourable resolution of certain prior year tax positions during the year. It is anticipated that, subject to the outcome of various uncertain tax positions, the Group's effective tax rate in 2007/08 may increase to a level of up to 37%, this being an approximation to the underlying effective tax rate for the Group.

Return on capital employed

The Group's ROCE was 22.8% (2005/06: 22.4%). In the US the ROCE was 21.5% (2005/06: 22.4%) reflecting the additional investment in an 11% increase in net new store space. In the UK there was an increase to 32.7% reflecting high leverage of capital employed (2005/06: 26.6%). US capital employed included in-house credit card debtors of £395.6 million at 3 February 2007 (£382.7 million at 28 January 2006).

Depreciation, amortisation and capital expenditure

Depreciation and amortisation charges were £50.3 million (2005/06: £46.2 million), £32.6 million (2005/06: £28.5 million) in the US and £17.7 million (2005/06: £17.7 million) in the UK. Capital expenditure in the US was £53.8 million (2005/06: £49.1 million) and in the UK was £12.4 million (2005/06: £26.8 million). The additional capital expenditure in the US is primarily due to the increase in the rate of new store space growth. While the decrease in the UK reflected a lower level of expenditure in line with the fluctuations in the number of stores due to be refurbished. Capital expenditure in 2007/08 is expected to be in the range of £85 million to £95 million reflecting a further increase in the number of new stores opened in the US and a planned increase in relocations and new store openings in the UK.

Dividends

In November 2006 an interim dividend of 0.4434p per share was paid (2005/06: 0.4125p). The Board is recommending to shareholders a final dividend of 6.317 cents (2005/06: 2.8875p) per share for 2006/07, which, subject to shareholder approval, is to be paid on 6 July 2007 to those shareholders on the register of members at close of business on 1 June 2007. Based on the exchange rate on 17 April 2007, this represents an increase in the total dividend for the year of 9.1%. The US dollar to pound sterling rate used to convert the 6.317 cents dividend per share for payment to shareholders who elect to receive a pound sterling dividend will be the rate as derived from Reuters at 4.00 pm on the record date of 1 June 2007. A letter sent on 18 April 2007 to shareholders on the register asked whether they wished to receive this and future dividends in US dollars or pounds sterling.

Future distribution policy will continue to take account of earnings, cash flow, gearing, and the needs of the business.

Under English law, dividends can only be paid out of profits available for distribution (generally defined as accumulated realised profits less accumulated realised losses, less unrealised losses) and not out of share capital or share premiums (generally equivalent in US terms to paid-in surplus). At 3 February 2007, after taking into account the subsequently recommended final dividend of 6.317 cents per share (2005/06: 2.8875p per share), the holding company had distributable reserves of £132.0 million (28 January 2006: £110.3 million).

In order to make further distributions in excess of this figure, the holding company would first need to receive dividends from its subsidiaries. In addition to restrictions imposed at the time of the 1997 capital reduction on the distribution of dividends received from subsidiaries, the payments of dividends from other tax jurisdictions may not be tax efficient. Furthermore, there may be other reasons why dividends may not be paid by subsidiaries to the holding company.

Financial review (continued)

Impact of constant exchange rates and 53rd week

The Group has historically used constant exchange rates to compare period to period changes in certain financial data. This is referred to as "at constant exchange rates" throughout this Annual Report & Accounts. The Group considers this to be a useful measure for analysing and explaining changes and trends in the Group's results. The impact of the recalculation of sales, operating profit, profit before tax, profit for the financial period and earnings per share at constant exchange rates and the impact of the 53rd week, including a reconciliation to the Group's GAAP results, is analysed below.

	2006/07 £m	2005/06 £m	Growth at actual exchange rates %	Impact of exchange rate movement £m	2005/06 at constant exchange rates (non-GAAP) £m	Growth at constant exchange rates (non-GAAP) %	Impact of 53rd week £m	2006/07 on 52 week basis at constant exchange rates (non-GAAP) £m	52 week growth at constant exchange rates (non-GAAP) %
Sales by origin and destination:									
UK	**482.5**	469.6	2.7	–	469.6	2.7	(7.3)	475.2	1.2
US	**1,410.7**	1,282.7	10.0	(54.6)	1,228.1	14.9	(20.8)	1,389.9	13.2
	1,893.2	1,752.3	8.0	(54.6)	1,697.7	11.5	(28.1)	1,865.1	9.9
Operating profit:									
UK – Trading	**55.0**	49.1	12.0	–	49.1	12.0	(1.8)	53.2	8.4
– Group function	**(7.4)**	(8.0)	n/a	–	(8.0)	n/a	–	(7.4)	n/a
	47.6	41.1	15.8	–	41.1	15.8	(1.8)	45.8	11.4
US	**173.8**	167.1	4.0	(7.1)	160.0	8.6	–	173.8	8.6
	221.4	208.2	6.3	(7.1)	201.1	10.1	(1.8)	219.6	9.2
Profit before tax	**213.2**	200.4	6.4	(6.7)	193.7	10.1	(1.5)	211.7	9.3
Profit for the financial period	**141.5**	130.8	8.2	(4.4)	126.4	11.9	(0.9)	140.6	11.2
Earnings per share	**8.2p**	7.5p	9.3	(0.2)p	7.3p	12.3	(0.1)p	8.1p	11.0

Liquidity and capital resources

It is the objective of the Group to maintain a strong balance sheet, after implementing its 8% – 10% new store space growth strategy in the US, the continuing programme of store refurbishments and relocations on both sides of the Atlantic, payment of dividends, and any repurchase of shares. Factors which could affect this objective would be the acquisition of a business or a change in the Group's distribution policy to shareholders or if there was a variation in the operating performance of the Group.

The cash flow performance of the Group depends on a number of factors, such as the:

- operating performance of the business;
- rate of space expansion, which influences both fixed and working capital investment;
- level of store refurbishment and relocations;
- level of inventory investment; and
- proportion of US sales made on the in-house credit card and the average monthly collection rate of the credit balances.

Investment in new space requires significant investment in working capital, as well as fixed capital investment, due to the slow inventory turn, and the additional investment required to fund sales in the US utilising the in-house credit card.

In years when the rate of new store space expansion in the US is towards the lower end of the planned 8% – 10% range, or the level of store refurbishment and relocation is below normal, the Group will have reduced levels of investment in fixed and working capital. In 2006/07 a faster rate of new store space growth in the US, and increased dividend payments, more than offset a lower level of refurbishment in the UK and meant that there was a cash outflow of £16.3 million (2005/06: £6.7 million) before the repurchase of shares amounting to £33.7 million (2005/06: £2.0 million) and proceeds from the issue of shares of £4.1 million (2005/06: £3.9 million).

The Group's working capital requirements fluctuate during the year as a result of the seasonal nature of its business. As inventory is purchased for the Christmas season there is a working capital outflow which reaches its highest levels in late autumn. This position then reverses over the key selling period of November and December. The working capital needs of the business are then relatively stable from January to August. The rough diamond sourcing initiative will require the Group to hold an element of its inventory for approximately an additional 60 days. The timing of the payment of the final dividend, normally in July, is also material to working capital requirements during the year.

The Board considers that the capital resources currently available are sufficient for both its present and near term requirements. A description of the main credit facilities of the Group are given in the next section, “Net debt”.

In 2006/07 cash generated from operating activities amounted to £182.2 million (2005/06: £188.1 million) after funding a working capital increase of £92.3 million (2005/06: £71.2 million), principally as a result of the growth of the US division. It is anticipated that in 2007/08 there will be a further increase in the level of working capital due to planned US store openings. Interest of £16.7 million (2005/06: £11.4 million) and tax of £69.2 million (2005/06: £64.7 million) were paid. Net cash from operating activities was £96.3 million (2005/06: £112.0 million).

Group capital expenditure was £66.2 million (2005/06: £75.9 million). The level of capital expenditure was some 1.3 times the depreciation and amortisation charge. Capital expenditure in 2007/08 is expected to be between £85 million and £95 million, most of which will be store related. There were disposal proceeds of £2.4 million (2005/06: £7.5 million). Equity dividends of £57.8 million (2005/06: £52.7 million) were paid, and £33.7 million (2005/06: £2.0 million) was utilised to repurchase shares. £4.1 million (2005/06: £3.9 million) was received from the proceeds of issuing shares. The increase in net debt before exchange adjustment was £45.9 million (2005/06: £4.8 million). In 2007/08 the increase in net debt is expected to be between £35 million and £45 million before exchange adjustments and movements in equity, reflecting a planned higher level of capital expenditure and an anticipated rise in tax and dividend payments. Up until 17 April 2007 share repurchases of £13.8 million have already been made in 2007/08.

Net debt

Net debt at 3 February 2007 was £118.4 million (28 January 2006: £98.6 million). Group gearing at the year end was 13.4% (28 January 2006: 11.2%).

Until November 2006 the Group funded part of its private label credit card receivables programme through a privately placed receivables securitisation of $251.0 million. Under this securitisation, interests in the US receivables portfolio, held by a trust, were sold principally to institutional investors in the form of fixed-rate Class A, Class B and Class C investor certificates. The certificates had a weighted average interest rate of 5.42% and interest was paid monthly in arrears from the collection of finance charges generated by the receivables portfolio. The revolving period of the securitisation ended in March 2006, and the final principal payment was made in November 2006, resulting in no aggregate outstanding principal amount of certificates as at 3 February 2007.

On 30 March 2006 Signet entered into a US Private Placement Note Term Series Purchase Agreement (“Note Purchase Agreement”) which was funded largely from US insurance sector institutional investors in the form of fixed rate investor certificate notes (“Notes”). These Notes represent 7, 10 or 12 year maturities, with Series (A) $100 million 5.95% due 2013; Series (B) $150 million 6.11% due 2016 and Series (C) $130 million 6.26% due 2018. The aggregate issuance was $380 million and the funding date was 23 May 2006. The proceeds from this debt issuance were used to refinance the maturing securitisation programme and for general corporate purposes. The Notes rank *pari passu* with the Group’s other senior unsecured debt. The principal financial covenants on this Note Purchase Agreement are identical to the Group’s $390 million multi-currency revolving credit facility which are as follows:

1. the ratio of Consolidated Net Debt to Consolidated EBITDA (Earning Before Interest, Tax, Depreciation and Amortisation) shall not exceed 3:1;
2. Consolidated Net Worth (total net assets) shall not fall below £400 million; and
3. the ratio of EBITARR (Earnings Before Interest, Tax, Amortisation, Rents, Rates and Operating Lease Expenditure) to Consolidated Net Interest Expenditure plus Rents, Rates and Operating Lease Expenditure shall be equal to or greater than 1.4:1.

On 28 September 2004 Signet entered into a $390 million unsecured multi-currency five year revolving credit facility agreement (the “Facility Agreement”). Under the Facility Agreement, a syndicate of banks made facilities available to the Group in the form of multi-currency cash advances and sterling acceptance credits on, *inter alia*, the following terms:

- the Facility Agreement bears a maximum margin of 0.55% above LIBOR, though the margin may be lower dependent upon the performance of the Group. Since the commencement of the facility the margin has been 0.40% above LIBOR; and
- the Facility Agreement is guaranteed by the Group’s principal holding and operating subsidiaries.

The continued availability of the Facility Agreement is conditional upon the Group achieving certain financial performance criteria (see above). It also has certain provisions which are customary for this type of agreement, including standard “negative pledge” and “*pari passu*” clauses. At 3 February 2007 and 18 April 2007 the amount outstanding under the Facility Agreement was $nil.

It is the policy of the Group to enter into interest rate protection agreements in respect of at least 75% of its forecast US dollar borrowings. At 3 February 2007 the interest rate of forecast US dollar borrowings for 2007/08 was capped effectively at 6.1%.

Pensions

The Group has one defined benefit plan (the “Group Scheme”) for UK based staff, which was closed to new members in 2004. All other pension arrangements consist of defined contribution plans. The IAS 19 present value of obligations of the Group Scheme decreased last year by £10.9 million (2005/06: increase of £33.4 million) primarily as a result of an actuarial gain of £17.3 million (2005/06: actuarial loss of £28.5 million). The market value of the Group Scheme’s assets increased by £6.5 million (2005/06: £19.8 million). As a result there was a retirement benefit asset on the balance sheet of £1.9 million (28 January 2006: £15.5 million obligation) before a related deferred tax liability of £0.6 million (28 January

Financial review (continued)

2006: £4.6 million asset). The triennial actuarial valuation was carried out as at 5 April 2006. There was a surplus and as a result no additional contributions were required as part of a recovery plan to eliminate a deficit.

The cash contribution to the Group Scheme in 2006/07 was £3.6 million (2005/06: £4.3 million), and the Group expects to contribute some £3.9 million in 2007/08.

Contingent property liabilities

Approximately 136 UK property leases had been assigned by the Group up to 3 February 2007 (and remained unexpired and occupied by assignees at that date) and approximately 27 additional properties were sub-let at that date. Should the assignees or sub-tenants fail to fulfil any obligations in respect of those leases or any other leases which have at any other time been assigned or sub-let, the Group or one of its UK subsidiaries may be liable for those defaults. The number of such claims arising to date has been small, and the liability, which is charged to the profit and loss account as it arises, has not been material.

Contractual obligations

Long term debt obligations comprises borrowings with an original maturity of greater than one year. Purchase obligations comprise contracts entered into for the forward purchase of gold and US dollars with an original maturity of greater than one year. These contracts are taken out to manage market risks. It is expected that operating commitments will be funded from future operating cash flows and no additional facilities will be required to meet these obligations.

Contractual obligations as at 3 February 2007

	Less than one year	Between one and three years	Between three and five years	More than five years	**Total £m**
Long term debt obligations	–	–	–	192.9	**192.9**
Operating lease obligations	142.3	263.0	224.4	582.6	**1,212.3**
Purchase obligations	27.3	–	–	–	**27.3**
Fixed interest and commitment fee payments	12.1	24.1	23.5	50.2	**109.9**
Creditors falling due after one year	–	–	–	16.3	**16.3**
Total	181.7	287.1	247.9	842.0	**1,558.7**

(1) As at 3 February 2007 the Group has no significant outstanding floating rate indebtedness.
(2) The expected Group pension contribution to the Group Scheme has been excluded from the table as have obligations for subsequent years. The Group expects to contribute some £3.9 million in 2007/08.

Prior year review of the 52 weeks ended 28 January 2006

Total Group sales rose to £1,752.3 million (2004/05: £1,615.5 million), up by 8.5% on a reported basis and 6.0% at constant exchange rates (see page 36). Group like for like sales were up by 2.4% and space changes contributed 3.6% (see table below).

Group operating margin decreased to 11.9% (2004/05: 13.2%), reflecting the significant decline in the operating margin of the UK division. While total sales increased, the decline in the operating margin resulted in Group operating profit decreasing to £208.2 million (2004/05: £212.5 million), down by 2.0% on a reported basis and 4.1% at constant exchange rates (see page 36).

Net financing costs decreased to £7.8 million (2004/05: £8.6 million). The reduction was principally due to an increase in interest income in the first half of the year.

Group profit before tax decreased to £200.4 million (2004/05: £203.9 million), down by 1.7% on a reported basis and 3.8% at constant exchange rates (see page 36). After a tax charge of 34.7% (2004/05: 33.9%) profit for the financial period reduced by 3.0% to £130.8 million (2004/05: £134.8 million), a decrease of 5.0% at constant exchange rates (see page 36). It is anticipated that the tax charge for 2006/07 will be approximately 36%. Earnings per share was 7.5p (2004/05: 7.8p), down by 3.8% on a reported basis and 6.3% at constant exchange rates (see page 36).

Sales

2005/06 sales growth

	US %	UK %	Group %
Like for like	7.1	(8.2)	2.4
Space	5.0	0.7	3.6
Exchange translation	3.7	–	2.5
Total sales growth	15.8	(7.5)	8.5

US

Like for like sales for the US division increased by 7.1% and total US dollar sales by 15.8%. The US division had a strong first half with like for like sales up by 7.9%. While the retail environment slowed a little in the second half of the year, the business continued to show solid growth with like for like sales up by 6.4% in the fourth quarter. The contribution from new store space and the impact of exchange rate movements is shown in the table above.

UK

The UK business experienced the sharpest deterioration in trading conditions for 14 years. Although the strategy of increasing diamond participation continued to drive improvements in key performance indicators such as average selling price, the volume of transactions was much reduced. For the year as a whole like for like sales decreased by 8.2% and total sales decreased by 7.5%.

Operating profit

Operating margin movement

	US %	UK %	Group %
2004/05 margin	12.9	15.1	13.2
Gross margin	(0.5)	0.6	(0.5)
Expenses	1.1	(5.2)	(0.5)
New store space	(0.5)	–	(0.3)
2005/06 margin	13.0	10.5	11.9

US

The operating margin in the US division increased slightly on last year to 13.0% (2004/05: 12.9%), with the leverage from like for like sales growth more than offsetting the impact of immature store space and the decline in gross margin (see table above). The ratio of net bad debt to sales was little changed at 3.0% (2004/05: 2.8%). Operating profit was £167.1 million (2004/05: £142.4 million), up by 17.3% on a reported basis and 13.6% at constant exchange rates (see page 36).

UK

The division's gross margin benefited from lower sterling commodity costs. The operating margin at 10.5% was down on last year (2004/05: 15.1%) due to the adverse leverage from the 7.5% decline in UK sales. Operating profit fell by 36.2% to £49.1 million (2004/05: £76.9 million).

Group costs

Group central costs amounted to £8.0 million (2004/05: £6.8 million), the increase including additional costs associated with new corporate governance practices and a net property provision of £0.7 million (2004/05: £0.4 million).

Return on capital employed

The Group's ROCE was 22.4% (2004/05: 26.3%). In the US the ROCE was 22.4% (2004/05: 22.2%) in line with last year. In the UK there was a marked decrease to 26.6% reflecting the decline in UK profitability (2004/05: 44.5%). US capital employed included in-house credit card debtors of £382.7 million at 28 January 2006 (2004/05: £319.0 million at 29 January 2005).

Depreciation, amortisation and capital expenditure

Depreciation and amortisation charges were £46.2 million (2004/05: £41.7 million), £28.5 million (2004/05: £24.3 million) in the US and £17.7 million (2004/05: £17.4 million) in the UK. Capital expenditure in the US was £49.1 million (2004/05: £41.7 million) and in the UK was £26.8 million (2004/05: £28.8 million). The additional capital expenditure in the US is primarily due to the increase in the rate of new store space growth.

Dividends

In November 2005 an interim dividend of 0.4125p per share was paid (2004/05: 0.375p). The Board is recommending to shareholders a final dividend of 2.8875p (2004/05: 2.625p) per share for 2005/06, which, subject to shareholder approval, is to be paid on 7 July 2006 to those shareholders on the register of members at close of business on 2 June 2006. Future distribution policy will continue to take account of earnings, cash flow, gearing and the needs of the business.

Under English law, dividends can only be paid out of profits available for distribution (generally defined as accumulated realised profits less accumulated realised losses less unrealised losses) and not out of share capital or share premiums (generally equivalent in US terms to paid-in surplus). At 28 January 2006, after taking into account the subsequently recommended final dividend of 2.8875p per share (2004/05: 2.625p per share), the holding company had distributable reserves of £110.3 million (29 January 2005: £116.0 million).

In order to make further distributions in excess of this figure, the holding company would first need to receive dividends from its subsidiaries. In addition to restrictions imposed at the time of the 1997 capital reduction on the distribution of dividends received from subsidiaries, the payments of dividends from other tax jurisdictions, such as the US, may not be tax efficient. Furthermore, there may be other reasons why dividends may not be paid by subsidiaries to the holding company.

Financial review (continued)

Impact of constant exchange rates

The Group has historically used constant exchange rates to compare period to period changes in certain financial data. This is referred to as "at constant exchange rates" throughout these accounts. The Group considers this to be a useful measure for analysing and explaining changes and trends in the Group's results. The impact of the recalculation of sales, operating profit, profit before tax, profit for the financial period and earnings per share at constant exchange rates, is analysed below.

	2005/06 £m	2004/05 £m	Growth at actual exchange rates %	Impact of exchange rate movement £m	2004/05 at constant exchange rates (non-GAAP) £m	Growth at constant exchange rates (non-GAAP) %
Sales by origin and destination:						
UK	**469.6**	507.7	(7.5)	–	507.7	(7.5)
US	**1,282.7**	1,107.8	15.8	36.9	1,144.7	12.1
	1,752.3	1,615.5	8.5	36.9	1,652.4	6.0
Operating profit:						
UK – Trading	**49.1**	76.9	(36.2)	–	76.9	(36.2)
– Group central costs	**(8.0)**	(6.8)	n/a	–	(6.8)	n/a
	41.1	70.1	(41.4)	–	70.1	(41.4)
US	**167.1**	142.4	17.3	4.7	147.1	13.6
	208.2	212.5	(2.0)	4.7	217.2	(4.1)
Profit before tax	**200.4**	203.9	(1.7)	4.4	208.3	(3.8)
Profit for the financial period	**130.8**	134.8	(3.0)	2.9	137.7	(5.0)
Earnings per share	**7.5p**	7.8p	(3.8)	0.2p	8.0p	(6.3)

Critical accounting policies

Critical accounting policies covering areas of greater complexity or those particularly subject to the exercise of judgement are listed below. There are no material off-balance sheet structures. The principal accounting policies are set out in note 1 on pages 80 to 84 in the Notes to the accounts.

Implementation of Adopted IFRS

These accounts have been prepared on the basis of Adopted IFRS.

IFRS 1 'First-time adoption of international financial reporting standards' grants certain exemptions from the full requirements of IFRSs in the transition period. The following exemptions have been taken in these financial statements:

- Business combinations – Business combinations that took place prior to 1 February 2004 have not been restated;
- Fair value or revaluation to deemed cost – At the date of transition fair value has been used as deemed cost for properties previously measured at fair value; and
- Financial instruments – The comparative information for the 52 weeks ended 29 January 2005 has not been restated on adoption of IAS 32 and IAS 39, 'Financial instruments'.

Revenue recognition

Where the contractual obligation is borne by the Group, revenue from the sale of extended service agreements is deferred and recognised, net of incremental costs arising from the initial sale in proportion to anticipated claims arising. This period is based on the historical claims experience of the business, which has been consistent since these products were launched. The Group reviews the pattern of claims at the end of each year to determine any significant trends that may require changes to revenue recognition rates.

Only the commission element of UK warranty sales is recognised as revenue.

Provision is made for future returns expected within the stated return period, based on previous percentage return rates experienced.

Insurance income and the impact of voucher promotions are recognised in revenue.

Interest receivable from the US in-house credit programme is classified as other operating income.

Inventory valuation

Inventory is valued on an average cost basis and includes appropriate overheads. Overheads allocated to inventory cost are only those directly related to bringing inventory to its present location and condition. These include relevant warehousing, distribution and certain buying, security and data processing costs.

Where necessary, provision is made for obsolete, slow-moving and damaged stock. This provision represents the difference between the cost of the stock and its estimated market value, based upon stock turn rates, market conditions and trends in consumer demand. For further detail on the provisions for inventory and the amount of reserves recorded each year, refer to note 13 on page 92.

In the US, stock losses are recognised at the mid-year and fiscal year end based on complete physical inventories. In the UK, stock losses are recorded as identified on a perpetual inventory system and an estimate is made of losses for the period from the last stock count date to the end of the financial year on a store by store basis. These estimates are based on the overall divisional stock loss experience since the last stock count.

Foreign currency translation
The results of overseas subsidiary undertakings are translated into pounds sterling at the weighted average rates of exchange during the period and their balance sheets and attributable goodwill at the rates at the balance sheet date. Exchange differences arising from the translation of the net assets of overseas subsidiary undertakings are charged or credited to reserves. Other exchange differences arising from foreign currency transactions are included in profit before taxation.

The functional currency of the parent company moved to US dollars from 5 February 2007. At the same time the reporting currency of the Group changed to US dollars. The relative size of the Group's US and UK businesses means that the exposure of the Group's reported results to exchange rate fluctuations will be reduced.

Hedge accounting
The Group took the exemption not to restate comparatives for IAS 32 'Financial instruments: disclosure and presentation' and IAS 39 'Financial instruments: recognition and measurement' in 2005/06. As a result, the comparative information in these accounts for the 52 weeks ended 29 January 2005 is presented on the previously existing UK GAAP basis. The Group applied the hedge accounting provisions of IAS 39 from 30 January 2005 as they relate to forward currency and commodity contracts in order to minimise future volatility.

Changes in the fair value of financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity through the consolidated statement of recognised income and expense. Any ineffective portion of the gain or loss is recognised immediately in the income statement. For cash flow hedges that result in the recognition of a non-financial asset or liability, amounts previously deferred in equity are included in the measurement of the asset or liability. For cash flow hedges that result in the recognition of a financial asset or liability, amounts previously recognised in equity are recognised in the income statement in the same period in which the hedged item affects the Group's net profit or loss.

Taxation
Accruals for tax contingencies require management to make judgements and estimates in relation to tax audit issues and exposures. Amounts accrued are based on management's interpretation of country-specific tax law and the likelihood of settlement. Tax benefits are not recognised unless the tax positions are probable of being sustained. Once considered to be probable, management reviews each material tax benefit to assess whether a provision should be taken against full recognition of the benefit on the basis of potential settlement through negotiation and/or litigation. All such provisions are included in creditors due within one year. Any recorded exposure to interest on tax liabilities is provided for in the tax charge.

Depreciation and impairment
Depreciation is provided on freehold and long leasehold premises over a useful life not exceeding 50 years. Freehold land is not depreciated. Depreciation is provided on other fixed assets at rates between 10% and 33 1/3%. Shopfit depreciation rates have been set based on the refit cycle for each store fascia and the useful lives of each individual element of the shopfit. Tills and other IT equipment have separately determined depreciation rates.

In the UK there are circumstances where refurbishments are carried out close to the end of the lease term, such that the expected life of the newly installed leasehold improvements will exceed the lease term. Where the renewal of the lease is reasonably assured, such shopfronts, fixtures and fittings are depreciated over a period equal to the lesser of their economic useful life, or the remaining lease term plus the period of reasonably assured renewal. Reasonable assurance is gained through evaluation of the right to enter into a new lease, the performance of the store and potential availability of alternative sites.

Where appropriate, provision is made on assets that have a recoverable amount less than net book value. Additionally, potentially impaired assets are identified by reviewing the cash contribution of individual stores where trading since the initial opening of the store has reached a mature stage. Where such stores deliver a low or a negative cash contribution, the related store assets are considered for impairment by reference to the higher of net realisable value and value in use.

Lease costs and incentives
Where operating leases include clauses in respect of predetermined rent increases, those rents are charged to the income statement on a straight line basis over the lease term including any construction period or other rental holiday. Other operating lease costs are charged to the income statement as incurred. Amounts payable in respect of turnover leases are charged in the period to which the turnover relates. Premiums paid to acquire short leasehold properties and incentives received relating to leased properties are amortised over the lease term.

Where the Group has onerous lease obligations, provision is made for the discounted cash outflow that is expected to arise under the lease. Account is taken of any sublet income received or reasonably expected, incentives to be received or paid and the time to lease expiry or reversal of the net cash outflow, whichever is the later.

The Group policy is to recognise a provision for onerous leases when the leased property ceases to be used by the Group.

Receivables
Trade and other receivables are stated at their nominal amount less impairment losses.

The bad debt experience of the US division has been relatively stable over the past ten years at between 2.8% and 3.4% of sales.

Financial review (continued)

UK retirement benefits
The surplus or deficit on the Group Scheme that is credited or charged to shareholders' equity through the Consolidated statement of recognised income and expense is subject to a number of assumptions and uncertainties. A qualified actuary is engaged to calculate the expected liabilities of the Group Scheme based primarily on assumptions regarding salary and pension increases, inflation rates, discount rates, projected life expectancy and the long term rate of return expected on the Group Scheme's assets. A full actuarial valuation was completed as at 5 April 2006 and the Group Scheme valuation is updated at each year end based on actuarial assumptions as of the year end date. The assumptions set are based on the advice of the actuary and details of these assumptions are given in note 21 on page 96. The sensitivity of the Group Scheme assets, liabilities and funded position to the assumptions made is presented on page 96. The discount rate is based on the yield at the balance sheet date of AA rated corporate bonds of equivalent currency and term to the Group Scheme's liabilities. The value of the assets of the Group Scheme is measured as at the balance sheet date, this being particularly dependent on the value of equity investments held by the Group Scheme at that date. The overall impact on the Group balance sheet is significantly mitigated as the members of the Group Scheme are only in the UK and account for less than 11% of UK employees. The Group Scheme ceased to admit new employees from April 2004.

Share-based payments
The Group recognises a charge to income in respect of the fair values of outstanding employee share options. The fair values are calculated at the grant date using the Black-Scholes option pricing model up to 29 January 2005 and for LTIP schemes thereafter and a binomial valuation model from 30 January 2005 and are charged to the income statement from the grant date over the relevant option vesting period. The key assumptions surrounding the valuation of employee share options include the risk free interest rate, expected life of options, expected volatility and dividend yield. The expected volatility is based on the five year average historical volatility. Full details of all assumptions are given in note 28 on page 103. The optional transitional arrangements, which allowed companies to apply IFRS 2 fully retrospectively to all options granted but not fully vested at the relevant reporting date, was used.