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Conference Call Transcript

SIG - Preliminary 2007/08 Signet Group Earnings Conference Call

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PRESENTATION

Terry Burman - Signet Group plc - Chief Executive

Good afternoon. I'm pleased to welcome all of you in the room and those joining us by Webcast and conference call. I'm Terry Burman, Group Chief Executive. With me is Walker Boyd, our Group Finance Director. I'll present an overview of the business, Walker will summarize our financial results, and then we'll be pleased to take your questions.

During this presentation we will be discussing Signet's business outlook and making certain forward-looking statements. Any comments that are not historical facts are subject to a number of risks and uncertainties, and actual results may differ materially. We encourage you to read the risk and other factors and cautionary language in the annual report on Form 20-F that was filed with the SEC in May 2007. We also draw your attention to the next slide and our press release, which is posted on our Web site, for more information on the risks and uncertainties.

Fiscal 2008 was a challenging year, particularly the fourth quarter. As a result, total sales were up 3% and like-for-like sales fell by 0.7%. Profit before tax was \$333 million, and earnings per share was \$0.126. The recommended final dividend is \$0.06317 per share, and the full-year dividend is up 1.6% to \$0.07277.

Return on capital employed was 16.8%, primarily reflecting lower operating profit and investment in new space. During the year net debt increased by \$143.6 million, after investing \$178.9 million in growth and distributing a net \$152.9 million to shareholders.

The Board has over time very carefully considered the allocation of capital between investing to improve the business, maintaining a strong balance sheet and distributing cash to shareholders. In fiscal 2008, \$79 million of capital was spent to maintain the high quality of our assets, and a further \$179 million invested in new space in the US, including both fixed and working capital. We require at least a 20% IRR over five years from our investments, well in excess of our cost of capital. Last year we distributed \$153 million to shareholders, 124 million by way of dividend. The Board believes that a strong balance sheet and flexibility in funding is a competitive advantage as it facilitates our consistency of execution, helps make us a favorite business partner for landlords and suppliers, and enables us to take advantage of the significant long-term growth opportunities provided by Kay, Jared and the rough diamond initiative to enforce the Group's already strong competitive position.

In recent months there have been fundamental changes in the environment in which we operate. The economic conditions have become much more challenging and the marketplace has increased in volatility. At the same time, the international credit markets have tightened considerably. Therefore, we have taken an opportunity -- an appropriately prudent approach. We have carried out a sensible cost reduction program across the group and implemented a more moderate store investment program, with US net space growth expected to be about 5% in each of the next two years, compared to the average of 10% for the last three years. As a result, investment in new space is expected to be reduced by some \$45 million per year.

As a result of these actions, net debt is anticipated to increase by about \$60 million in fiscal 2009, subject to the general economic uncertainties, and that's compared to an increase in net debt of \$144 million in fiscal 2008. These actions will help us to maintain a strong balance sheet.

Given the substantial increase in economic and financial sector uncertainties, the Board will continue to evaluate dividend policy in light of the needs of the business, taking into consideration the significant competitive advantages of a strong balance sheet and financial flexibility. Account will also be taken of the primary stock market listing of the Company.

Turning now to the US business, total sales were up 2%, and like-for-like sales fell by 1.7%, with the major gift-giving events being disappointing, particularly Christmas. This reflected growing pressure on consumers' disposable income.

Operating profit was \$262 million with an operating margin of 9.7%, as a result of both gross margin pressure from higher commodity costs and deleverage of the expense base. Return on capital employed was 14.9%, due to the profit performance and further investment.

Looking at the divisions' performance in an industry context, our five-year average operating margin of 12% is more than twice that of the industry as a whole, or our largest specialty competitor. And the ratio of year-end EBIT to total assets over the same five years is also significantly higher. You should note that while the figures for a typical specialty jeweler are a year out of date, they are the latest ones available. When data is published for 2007, we would anticipate it showing a further -- a deterioration in the industry performance.

Looking beyond the financial ratios of the business, we made good further operational progress. Net new store space was again at the top end of our 8 to 10% target range. The rollout of our enhanced training procedures to all stores was completed. The rough diamond initiative moved from a trial to implementation, with significantly increased volumes of rough purchased. The number of exclusive items and ranges was increased, providing greater differentiation in the marketplace. Jared had sufficient scale to advertise on national network television for the first time, and we continued to improve store execution -- for example, with the rollout of broadband to stores, which enabled a new communications software tool called the Sterling Performance Matrix to be implemented. This has improved productivity and store personnel effectiveness.

Turning to the broader environment, trading continues to be negatively affected by the macro environment and economic issues, compounded by a record gold price. Year-to-date US like-for-like sales are down about 4%, which included the benefit of better weather over Valentine's Day. The outlook for the balance of the year remains very challenging. Longer-term, the outlook is more positive, given the relationship between jewelry sales and growth in disposable income, in addition to the forecast increase in the number of weddings.

Jewelry prices are likely to be supported by an imbalance in diamond supply and demand, which is beginning to be seen, placing greater emphasis on our supply chain expertise. These factors can be expected to accelerate sector consolidation in both the short and the long-term, leading to an increased market for the best operators.

Our market share remained at a similar level against the background of a comparatively weak middle market sector. Zale saw a further fall and is closing over 100 stores this year. The figures for other chains are not available until later this year, but Friedman's/Crescent, which is a super-regional, is closing all but 80 out of 470 stores during 2008. Two small Northeastern chains, Fortunoff and Alpha Omega, also entered bankruptcy. We believe that there will be further capacity reduction in 2008.

Our response to the current environment is to manage the business tightly by closely monitoring gross margin dollars, strictly controlling inventory, realigning costs to the reduced sales base where possible, and maintaining our credit standards, and consistent application of our stringent real estate investment criteria, with sales models which are stressed to reflect the changed market conditions.

Looking at gross margin in more detail, diamonds represented about 50% of our cost of goods sold last year. Polished diamonds in the qualities and sizes we purchase saw little change in cost during the past two years. However, we are seeing higher rough prices, which at some stage will impact the polished prices.

Gold represented about 20% of the cost of goods sold for 2008. Of the cost of goods -- the cost of gold has increased by some 30% in each of the last two years, and is now at record levels. We continue to mitigate these increases with further supply chain efficiencies, but our major response is the price increase implemented post-Valentine's Day.

We raised our prices after extensive analysis of our pricing architecture. The increases were in both basic and fashion ranges. Some increases have previously been taken in the fashion category. Changes were clearly communicated to our sales associates and appropriate training given to overcome consumer objections. The adjustments were efficiently executed, assisted by our new store communications system. Additional targeted promotional activity has taken place to underpin sales and support the sales staff. Results are being closely monitored by merchandise category. We can quickly implement further contingency promotional programs if necessary, and competitors face the same commodity cost pressures and have to put up some prices. Industry commentators are expecting further increases to be implemented.

With regard to the consumer, early results have been encouraging. However, we don't expect to be able to fully evaluate the success of this initiative until sometime later this summer.

We have realigned expenses to current sales levels where possible without cutting at the fabric of our business or harming our long-term prospects. For example, our marketing spend as a percentage of sales in fiscal 2008 reached 7.5%, against our average of just under 7% historically. It's planned to be in line with our historic level in fiscal 2009.

We have adjusted our store staffing hours where possible, while keeping our well-trained and motivated people. Home office staffing level has been frozen in spite of the growth in store numbers. We have also delayed initiatives with medium-term paybacks in future years, and a range of miscellaneous costs have been trimmed. We continue to improve operating procedures and the Sterling Performance Matrix is expected to further increase in-store productivity, while also allowing us to be more proactive and flexible in the marketplace.

We have stressed our sales assumptions for CapEx purposes. As a result, fewer lease renewals and potential new stores achieved our demanding 20% IRR hurdle rate for investment. Therefore, new store space growth in fiscal 2009 is planned to be 5%, net of about 30 store closures. While this is below our 8 to 10% growth rate target, it is prudent in the current environment and does not reflect any long-term downgrading of the growth potential. This will save about \$45 million of fixed and working capital.

Now let's look at our formats in more detail. In terms of the specialty market, Kay, with sales of nearly \$1.5 billion, is now about 40% larger than the number two brand. This gives Kay a tremendous advantage as it spends a higher proportion of sales on advertising, has more effective execution and a consistent message across all of the marketing channels. During fiscal 2008, the number of Kay stores increased by just over 7% to almost 900, with about three-quarters of the increase being in off-mall locations. In fiscal 2009 a further net increase of about 4% is planned, nearly all off-mall. The test of outlet centers is proceeding well.

Jared sales were up by 14% and the store base has increased to 154. The concept is still immature, with only about 44% of stores being more than five years old. National network TV advertising was used over Christmas 2007 for the first time, following the move to national cable advertising for Christmas 2006. And it's planned to start the use of national radio advertising during fiscal 2009. Jared again exceeded its sales pro formas in fiscal 2008 and continued to give a return of more than 20% on an IRR basis over five years. The mature locations on average achieved sales of some \$6.4 million.

Regional brand sales declined by 8%, adversely impacted by the trading environment and by sites opened in new markets in recent years that have not met their sales forecasts. We now only commit to open regional locations where there is already marketing support. We have reviewed the existing stores using strict return on capital employed and return on marketing criteria, and as a result, the number of regional stores is expected to climb by 14 this year. In the current environment, an acquisition is less likely, as good businesses usually only come onto the market in more buoyant times.

Looking at the distribution of our space, in fiscal 2009 all of our space growth is expected to be off-mall. We identified the need to better balance our real estate portfolio sometime ago, and now about 40% of our space is in off-mall locations, compared with 25% five years ago. This is predominantly Jared space, but Kay is also growing away from covered centers. As a result, we are increasingly competing against independents rather than our traditional mall-based competitors.

Now turning to our UK business. Despite the difficult Christmas period, like-for-like sales grew by 2%, with Ernest Jones up by 2.9 and H.Samuel by 1.3%. Total sales were little changed in sterling given the reduction of 18 stores. On a 52-week constant exchange rate basis, operating profit and margins were similar to last year, once more reflecting very good cost control.

To put the operating margin into context, in fiscal 2007, the latest year for which data is available, it was about 50% greater than the average of the next five largest specialty jewelers in the UK. The division's free cash flow is strong, with inventory up a little. Depreciation was about \$13 million more than CapEx. Return on capital employed at 29.9% was also healthy, and considerably in excess of our cost of capital.

Further progress was made in all of the basic retail disciplines. Training programs were strengthened. The cumulative benefit of the focus on improving service and product knowledge is clearly being seen in customer feedback. The enhanced Ernest Jones store design, which I'll come back to, has produced many very encouraging results. And the new H.Samuel TV commercial was a major step forward. There was increased product availability in store, which complemented the better-targeted and more effective promotional activity. The introduction of the third-party branded store card was successfully completed and is a useful additional tool in facilitating sales. We continue to focus H.Samuel on larger shopping centers that offer greater potential for growth, and 17 marginal stores were closed during the year.

As nearly all retailers have been reporting, the current economic environment is difficult, although employment remains stable. Therefore, we continue to keep a tight control of costs. In addition, the sterling cost of gold has started to increase over the last 12 months. Price increases have been implemented which partly mitigate this impact.

As regards trading, year-to-date like-for-like sales are up mid single-digits, reflecting good execution in the UK by the management team. However, the outlook continues to remain challenging. We continue to better target our promotion -- to better target our promotional activity, which has been successful in driving footfall. This is not necessarily at the expense of gross margins. We intend to make more use of our scale and buying power with more special purchase initiatives.

We are also maintaining our capital discipline and focus on achieving strong returns on capital and cash flow. Ernest Jones now accounts for about 12% of group sales and has the highest space productivity within the group. Due to the challenge of gaining further premium watch agencies, the store numbers have remained about 200 stores, and this is unlikely to change very much in the future. In fiscal 2008, Ernest Jones improved like-for-like sales growth to 2.9%. There was good growth in watches. However, diamond body jewelry was weak, particularly over the Christmas season. We intend to address this through a range of measures.

We successfully tested our new store design in seven locations in the second half of the year. The design greatly increases brand differentiation and gives the store a more fashionable, contemporary look, in marked contrast to many other middle market stores -- upper middle market stores. Utilization of store space is also enhanced. In particular, there is an expanded display area for watches, with much clearer branding, in a manner consistent with the overall design. There's also a greatly improved diamond bridal sales area, which not only helps this category, but also allows the other jewelry merchandise to be better presented. We have been pleased by how well the design has been received by both customers and our suppliers.

H.Samuel improved its like-for-like sales performance in fiscal 2008 despite the challenging trading environment. The brand has been successfully repositioned over the last five years. It is now seen much more as a jeweler and less as a gift shop. It has greatly improved customer service, due to both better-trained staff and a more customer-oriented store design. The merchandise range has been rationalized and now has greater focus, making it much easier to shop. ASPs have increased, reflecting a rebalancing of merchandise to diamonds, fashion watches and exclusive ranges, and away from gifts, collectibles and low-end watches and jewelry. These initiatives have helped to distance H.Samuel from increased competition at the lower end of the market from supermarkets, discount jewelers and catalog showrooms. In fiscal 2008, the advertising was more effective, and we also improved the coordination between marketing staff training and merchandising. Better use was also made of special purchase initiatives to drive footfall and sales.

As part of the repositioning process, we have also been focusing the store portfolio, which is helping to drive improved returns. Reflecting customer shopping patterns over the last two years, we have closed a net 27 H.Samuel stores with limited growth potential in smaller markets. We plan to have net closures of about 12 in fiscal 2009. This program is releasing working capital, eliminating units with marginal contribution, and helping drive productivity in the remaining locations through transfer sales. The focus on larger centers is reinforcing the new brand positioning, as we can invest in the customer-oriented format, which enables us to deliver higher standards of service in a better store environment with a broader merchandise selection, and allows us to maximize our competitive advantages. Half the division's stores are now located in our open customer-oriented format, and represent a similar proportion of sales. In three years, 82% of our store base will have been converted.

So, in summary, we continue to implement our proven strategy on both sides of the Atlantic. However, decisive action has been taken to adjust our execution to the very challenging trading environment. Costs, gross margins and inventory are being tightly controlled, and we continue to closely monitor our receivables. While maintaining a very disciplined approach to capital, where we see attractive returns, such as from Jared,

Kay in off-mall locations, the rough diamond initiative, and the Ernest Jones refit, we will continue to invest. In the current trading and financial environment, a strong balance sheet is an important competitive advantage, and it's one that we intend to keep.

Now I'd like to hand over to Walker for the financial review before taking questions.

Walker Boyd - Signet Group plc - Finance Director

Good afternoon. As you will recall, this is the first set of full-year results that we have presented in US dollars. Fiscal '08 was a challenging year, particularly the fourth quarter, and this is reflected in an EPS of \$0.126, down 18%. The favorable dollar exchange rate movement and the absence of the 2006/07 53rd week largely offset each other, such that on a 52-week basis at constant exchange rates, EPS was down 19%.

The Board recommends a dividend of \$0.06317, giving a small full-year increase. Importantly, balance sheet ratios remain strong, with fixed charge cover at 1.8 times and gearing of 21% at year-end. Group like-for-like sales for the year declined by 0.7%, reflecting a challenging US retail marketplace and a UK performance adversely affected by a difficult Christmas period.

In the US, net new store space saw non-comp sales growth of 5.8%, with total sales up by 4.1% on a 52-week basis. Last year's 53rd week had an adverse effect of 2.1%, with the overall reported increase of 2%.

In the UK, sales on a like-for-like basis were up by 2%, with a small negative impact from space changes. The movement in exchange rate from \$1.88 to \$2.00 had a 6.5% benefit, and after accounting for last year's 53rd week, reported sales increased by 5.8%.

Reported Group pre tax profits decreased by 17%, and again, the benefit of exchange translation and the adverse impact of the 53rd week largely offset each other. Group costs were slightly higher as a result of additional professional fees. Interest charges at constant exchange rates saw an increase of \$3.6 million, primarily reflecting the impact of the share buyback program completed in the early part of 2007/08.

Group operating margin was 9.6%, down 220 basis points on a 52-week basis. In the US, the 30 basis points decline in gross margin was a little less than we had forecast, as the mix in the fourth quarter was favorable. The like-for-like performance meant the expense leverage was negative by 190 basis points. And as expected, the impact of new space was adverse by 60 basis points. While the US margin was down 280 points to 9.7%, as Terry has noted, it remains significantly above that typical in the US specialty jewelry sector. UK gross margin was down 60 basis points, reflecting mix factors such as the strong watch performance and the growth of Ernest Jones. Very tight control of costs resulted in a 40 basis point improvement in SG&A. On a 52-week basis the UK operating margin was slightly down by 20 basis points at 11%.

Moving on to the credit portfolio. Over the last 10 years, the performance of the book has been within a tight range, although it was at the high end in fiscal 2008. Consumers' financial position continues to deteriorate, and this may lead to a further increase in the bad debt charge, although we would expect this to be somewhat offset by additional income from the portfolio, given a reduction in the collection rate. Credit authorization criteria continue to be reviewed, and outstanding balances are very closely monitored, with prompt action taken in response to changes in performance. In addition, further investment in collection systems is taking place.

Last year the average size of the book was \$795 million, financed from general corporate funds. We continue to strongly believe that our in-house credit offer is a competitive advantage, allowing us to manage the portfolio consistent with our operating strategy, rather than being exposed to the risk of a third-party bank deciding credit policy based on their balance sheet needs.

Turning to two of the key performance indicators of the portfolio. Last year the monthly collection rate was 13.9%, down from 14.6, resulting in an increase in earnings from the credit book. This reduction reflects a small change in the average monthly payment, which remains meaningfully above the minimum. The bad debt range of 6.5% was at the high end of the historic range. The proportion of sales through the in-house credit card increased slightly to 52.6%, with the number of active credit accounts being some 940,000, up 4.9% on fiscal 2007. The average outstanding balance was \$997, up 4.2%. Overall, whilst virtually all of our metrics on credit reflect a weaker consumer, none show fundamental changes in the performance of the portfolio.

The effective tax rate was 35.5%, lower than indicated at the third quarter, helped by the geographic mix of profits and the favorable resolution of prior-year positions. Tax rate for fiscal '09 is expected to remain about 35.5%, but is subject to more volatility going forward following the implementation of FIN 48. Given the profit performance in fiscal '08, we anticipate making lower tax payments in the new year.

Turning to our cash flows, this slide demonstrates the underlying cash flow of the Group and the investment in US space growth. Operating cash flow was down \$55 million, but still a healthy 466 million. Working capital, excluding the impact of US space growth, was up \$52 million, attributable to year-end inventory being about \$30 million above plan given the difficult fourth quarter, and an adverse movement in creditors resulting from an acceleration in vendor payments, reflecting overall advantageous terms.

Capital expenditure excluding new space in the US was \$13 million higher than last year, reflecting the timing of the refit cycle and higher infrastructure spend. As Terry has noted, \$179 million was invested to fund 10% US space growth. Net distribution to shareholders through dividend payments and net share purchases was \$147 million, down a little on fiscal 2007, with a 34 million reduction in the level of share buybacks. Overall cash outflow was 143.6 million before exchange rate movements. As a result, net debt increased during fiscal '08, from 233 million to 375 million, but gearing was still low at 21%.

For fiscal '09, given the challenging economic conditions, net new space in the US of around 5% is planned, including an anticipated 30-store closure. As a result, investment in new space this year is likely to be some \$45 million lower. All decisions, whether they be new stores, refits or indeed lease renewals, remain very much subject to the same strict operational and financial criteria as before. A required return of 20% IRR on a five-year DCF basis on stressed sales models ensures a return in excess of our cost of capital. Moreover, we are well aware that new stores are a constraint on balance sheet ratios such as fixed charge cover, further increasing our focus on the quality of our real estate.

As well as the decreased investment in US space growth, the realignment of inventory and reduced tax payments should lead to a lower level of cash outflow in the new year. These savings will to some extent be offset by the increased UK refurbishment program and the further development of the rough diamond initiative. Subject to the general economic environment, we would expect an increase in net debt this year of between 40 and \$80 million, against 144 in fiscal '08. We continue to firmly believe in the advantage of a strong balance sheet, enabling us to build further on our competitive strengths, in marked contrast to a number of other jewelers, particularly in the US.

Let me close with a review of the domicile and listing issue. The Board believes there is a clear rationale for the primary listing of the Group to be in the US, with over 70% of assets and profits located there. As a result, the typical US investor has a better understanding of the Group's brands, their position within the marketplace, the general economic environment, and has a much smaller foreign exchange exposure -- all factors which mean US investors require a smaller risk premium than UK investors. A relisting would also reflect the changing shareholder base of the Company, with now approaching 50% of the register US managed, and this would remove the potential for dual reporting requirements. Following consultation with our major shareholders, the Board believes shareholders would on balance support a recommendation from the Board regarding a potential redomicile of the Company to Bermuda, and a move of the primary listing of the shares to the US. And accordingly, the Board continues to take steps that would facilitate such a change. However, in light of market conditions, the determination and timing of any such proposal remains uncertain and will be kept under review by the Board.

Moving domicile and listing is an entirely separate issue from becoming a domestic issuer for SEC purposes. This is automatic when US beneficial holders account for over 50% of the equity, and relates purely to reporting requirements. A change in primary listing and/or domicile has to be approved by 75% at a general meeting of shareholders, and also by the High Court. Having considered a range of alternatives, the choice for the domicile of the Company would very probably be Bermuda, as its legal system is similar to the UK, it's helpful in the transition to a domestic US shareholder base, and avoids some tax disadvantages of moving to a US domicile.

I'll now hand you back to Terry and we'd be happy to take questions.

Terry Burman - Signet Group plc - Chief Executive

We'll be pleased to take your questions, and we'll start with those people present in the room. We'll then go to those joining us by conference call, before returning to the auditorium for any further questions. Please state your name and organization. And if you're in the room, please wait for a microphone so that those joining by telephone can hear you.

QUESTION AND ANSWER

Andy Hughes - UBS - Analyst

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Andy Hughes, UBS. Can you give us a little bit more detail on what's happened to pricing in the US, the degree to which you've put prices up, and whether those increases have actually stuck, or whether you've actually retreated at all in any areas?

Terry Burman - Signet Group plc - Chief Executive

In terms of stuck, you can measure this initiative in weeks, not months. We've had three segments of price increases -- one that we did right after Valentine's Day, one on the first of March, and one right at the end of March. So we haven't had very long to evaluate. But from what we've seen, the prices have certainly stuck. That doesn't mean that unit sales haven't been impacted. But in terms of gross margin dollars, we're encouraged by the results that we are achieving out of the initiative. It also gives us -- the price increases give us an opportunity to increase our promotional cadence somewhat. So all in all, we're encouraged by the price increases. We're not going to say how much they went up. And frankly, it's different in each category, so it would be misleading to say that. But it's really proprietary and, frankly, forbidden by antitrust rules in the US.

Andy Hughes - UBS - Analyst

You say others are following suit. Is that correct from what you said in your presentation?

Terry Burman - Signet Group plc - Chief Executive

Yes. Recognizing that we've been planning this since late last fall. We've had a chance to analyze and develop our pricing architecture and our price increases. So I'm certain that competitors are studying the moves that we made, and then studying their own pricing architecture. But we've already seen some meaningful movement in prices. And it's different across different categories; it's different across different formats, on-mall, off-mall (inaudible) competing against nationals or independents. And that's why it's going to take us a while to evaluate this, because we have to evaluate it category by category, format by format. And if it requires some adjustments, we'll make some adjustments as necessary. But so far, so good. It's early days.

Andy Hughes - UBS - Analyst

The minus four that you produced (inaudible) underlying -- true underlying figure. (inaudible)

Walker Boyd - Signet Group plc - Finance Director

It's a guide, because, obviously, the impact of the very bad weather we had right on Valentine's Day last year is something of an estimate. (inaudible) probably had a benefit on the nine-week period of about 2%.

Mike Dennis - Piper Jaffray - Analyst

Mike Dennis, Piper Jaffray. Could you give us the time period you said about rough to polish diamond prices going up? You said it would happen in the near-term. Tell us when you think that's going to come through in terms of price increases there. And also, on the costs, you talked about your miscellaneous costs, and managing them in short-term initiatives. Could you give us some more appreciation of the size of what miscellaneous costs are, and what short-term initiatives means in terms of the cost base?

Terry Burman - Signet Group plc - Chief Executive

In terms of the diamond -- the rough diamond prices, frankly, I would have thought they'd have gone up by now. The rough diamond prices have been increasing in the qualities that we buy. In the upper end -- let me rephrase here. In the upper end, the rough diamond prices have been increasing for about three years now, three to four years, steadily, and those prices are being passed onto the consumer. So at the higher qualities, bigger sizes, over three carats, better quality.

In the lower qualities and smaller sizes, rough diamonds have also been increasing for about the same amount of time, but not at the same rate, at a lower rate. The prices are not being reflected -- the prices -- the increased prices of rough are not -- have not been -- have not been reflected in the polished prices. So, obviously, that's unsustainable, but that's what has occurred. There was a little firming of prices a couple years ago.

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Outside of that, for the last couple of years, polished prices have been pretty flat. So one would think that -- just the laws of economics; those are going to have to be passed on at some point. That can't continue. The timing I can't speak about. It will happen when it happens. When it happens, with our rough sourcing initiative -- and we're the only ones in the middle market sector that are doing that -- it is becoming a meaningful part of our purchasing -- it will give us a competitive advantage, both the access and pricing. In terms of costs --

Walker Boyd - Signet Group plc - Finance Director

I think when we say miscellaneous expense, there are a whole raft of things from tests in terms of medium-term initiatives, the test to say the regional advertising is certainly one which has gotten, we believe, a long-term benefit, but in the short-term is not likely to give us a return. So that certainly is one area that we would be looking at. You then start going down the whole P&L; you look at travel budgets, all the way down. I don't think in terms of quantifying them line by line is helpful; certainly we would be seeking to keep our underlying expense rate increase down to the very low single-digits in the current year. And obviously, US expenses would rise by somewhat more than that, because with 10% space growth last year and 5% this, there is a larger increase. But underlying, we'd be seeking to try and mitigate expenses to the very low single-digits.

Rod Whitehead - Deutsche Bank - Analyst

Rod Whitehead, Deutsche Bank. You mentioned the meaningful amount of rough diamond purchases. I think in the past you've talked about 55% of your diamond product being loose diamonds rather than bought complete. Can you give us any kind of idea of what proportion of that is now being bought as rough rather than polished? And secondly, the depreciation charge went up 14%; I assume some of that was the currency impact from the UK -- whether you could break that out, and what you expect for the year ahead on a constant currency basis.

Terry Burman - Signet Group plc - Chief Executive

As soon as I said meaningful I knew somebody was going to ask that question. How much equals meaningful? I guess if you define meaningful - Walker's turning white over here -- it would be over 10% of our total diamond purchasing. But just how much, we're not -- we don't want to start getting measured against these targets. We have -- the initiative is robust. Walker and I just got back from Antwerp, where we were reviewing our rough sourcing office. And we're pleased with the infrastructure, the systems that we're building, the people that we've hired, and the initiatives that they have. And as we do with any initiative, we put it into place and we start expanding it. But we want to make sure that we get our processes and procedures well entrenched and improved so that we get the maximum results out of that, which we're doing. And that's the process that we're going through. And before -- we've had some significant expansion on a percentage basis. As I said, it's become a meaningful part of our sourcing. We want to get it right. As we get it right, we're comfortable with that, continue improving things, then we'll continue to expand it.

So there's no rush here. We'll do it as we always do, and make sure our operating processes are good. We are pleased by the progress that we're making. We're pleased by the opportunity that it will give us. Anybody that understands the supply chain, or has worked in the supply chain, would understand the competitive advantage that it will give us, especially if those -- if the margin between rough and polished starts to open up again. And you've already heard my views on that. In terms of depreciation --

Walker Boyd - Signet Group plc - Finance Director

Depreciation -- certainly there was an impact on the charge because of exchange movement moving from the 1.88 to 2. I think also there's some additional depreciation, effectively accelerated depreciate charges, because in the US, if we've got 30 store closures in the current year, we would tend to take a provision for these right off of the assets at the year end. And on a similar vein in the UK, where we're going into a deeper, more extended (inaudible) refurbishment program, again, that takes -- we have a higher charge (inaudible). So, for the year going forward, at constant rates, there is expected to be a more normal increase in line with the store portfolio, unless of course the cycle of refits and/or closures were to change again. But these two factors, more closures and a higher refit program in the coming year, as well as the currency impact, were the factors that caused a higher depreciation charge.

Tony Shiret - Credit Suisse - Analyst

Tony Shiret, Credit Suisse. On the gross margin in the US, I think you've given the impression in the past that your aim with your price increase is to have a stable gross margin in the US this year versus the year you've just reported. My understanding is that basically that's going to be

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delivered with a higher gross in the first and a lower gross in the second, as your costs come through progressively during the year against the price rise you've just done. So, first of all, could you confirm that's your understanding? Secondly, could you tell us, does that mean arithmetically that the gross margin is going to go down next year? Because theoretically, you're going to have a sort of -- you may need to reset prices again if you're going to maintain the gross next year. Is that a reasonable interpretation?

Walker Boyd - Signet Group plc - Finance Director

I think all other things being equal, arithmetically that would be correct. But in today's environment, all those things are not necessarily equal. So I think when we start thinking about gross margins for next year, that will be largely dependent or driven by what's happening to gold price and what's happening in terms of consumer and competitor reaction. But arithmetically, yes; you would be correct. Because the move, if you like, from the average in gold price that we had at the beginning of the year, to let's say \$900 (inaudible) that will happen progressively through the course of this year. So, yes; the wraparound would, say, all other things being equal, that's the answer you would get. Clearly, there are a lot of moving parts before we start looking at what the reality is likely to be.

(multiple speakers)

Terry Burman - Signet Group plc - Chief Executive

The strategy, the strategy is to offset the increased promotional cadence, and have a gross margin that is at least, at least equal to or somewhat better than the prior year.

Tony Shiret - Credit Suisse - Analyst

Okay. So as far as you're concerned on price increase, is it your intention you're going to put price up again this year? That's one question.

Terry Burman - Signet Group plc - Chief Executive

This year? No, not this year. We'll look at it again next year.

Tony Shiret - Credit Suisse - Analyst

You gave us some very helpful long-term margin stats. I just wondered where you think the US margin is going to settle out in the medium-term, whether you'll recover -- how much of this deleverage you'll recover.

Terry Burman - Signet Group plc - Chief Executive

You're talking about operating margin (multiple speakers). It's very dependent on average store productivity. That is the main driver. That's always going to be the main driver of operating margin. It's going to depend on like-for-like sales, and I'd have to start predicting are we going to -- how long, how deep a slowdown is this going to be, or whatever you want to call what's going on now.

Tony Shiret - Credit Suisse - Analyst

What do you think you've lost already? Do you think you'll get back into double digits? Is that --

Terry Burman - Signet Group plc - Chief Executive

I would expect us to. Yes, I would expect us to. But it depends on -- we're not immune to the economic environment. We operated for six, seven years in double-digit operating margins. So right now I would have to consider single digits the anomaly, the exception, not the rule. But it's going to take some work to get back up there. Primary drivers still being -- we can trim the cost around the edges; we can work on the gross margin. But the primary driver is going to be store productivity.

Chris Walker - Lehman Brothers - Analyst

Chris Walker, Lehman Brothers. Could you just comment on your stock position at the moment, and the quality of that stock, and if there's any risk going forward to discounting? I think some of your competitors have been discounting recently. And secondly, could you comment on your dividend as well? You mentioned that was under review going forward. [Can you comment on the criteria around that please]?

Terry Burman - Signet Group plc - Chief Executive

In terms of our inventory, I'm very comfortable -- we are very comfortable as an organization with our ability to clear through our merchandise in a timely basis. We don't see any exceptional measures having to be taken due to backup in the stock. Our clearance product as a percentage of our total remains consistent with the prior year. We responded well to the slowdown over the Christmas period. We ended across the Group with about \$30 million of inventory above plan; this is on a total inventory of 1.4 billion? 1.4, 1.5 billion inventory. We can clear through that excess. The excess was in very salable goods. So we're not concerned as we clear through -- the rate of turnover on our clearance remains consistent. Our standards have not been relaxed in any way, shape or form, in terms of recognizing clearance merchandise, and they've served us well. And our margins and our sell through on our clearance remain consistent. We don't anticipate any problems from that. We manage that -- we manage that issue very closely and maintain standards for clearance product and when it's appropriate to start clearing that. So, very comfortable with our stock position.

In terms of our dividend policy, we're -- in difficult times like this, when nobody understands how deep or how long any -- these conditions may last, we felt it was appropriate to remind everyone of our dividend policy. We haven't said anything or done anything new, except we're bringing everyone's attention to the fact that maintaining a strong balance sheet and financial flexibility to invest in the business is an import criteria for us in determining how to allocate our cash. And we're just reminding everyone of our priorities, and we'll see how the market -- we'll see how things develop.

John Baillie - Societe Generale - Analyst

John Baillie, SG. Could you sort of bring us up to date on the credit operation, its trend? You flagged slightly bigger bad debt in 2007 (inaudible) Q1. Has there been a further shift during Q1 (inaudible) how that is moving, and the takeup of credit (inaudible) within the sales mix?

Walker Boyd - Signet Group plc - Finance Director

In terms of where Q1 is going, obviously, it's more important where we see the rest of the year. I think our comments -- my comments about the financial position of consumers continuing to deteriorate says so long as that is the likely expectation, then clearly it's more than a possibility that our bad debts will continue to increase; again, somewhat offset from a P&L perspective, because even those who are (inaudible) vast majority do pay, if they take longer to pay, then the income on the portfolio goes up. So in that sense we get some relief from that. I don't think in the nine weeks we have seen -- I made the comment any fundamental change. We haven't since then seen that fundamental change either. But, just as our sales are not in the (inaudible) economic cycle, neither is our credit portfolio from consumers' position. And that financial position certainly doesn't play -- at the moment you won't see (inaudible) likely to improve in the foreseeable future.

Andy Hughes - UBS - Analyst

Andy Hughes again. Can you say what you think your peak net debt requirement will be in the current year? Can you confirm that you've got sufficient headroom in all your facilities for that?

Walker Boyd - Signet Group plc - Finance Director

I have to confirm the latter, because I just (inaudible) and the auditor is sitting in the back row. I'm not going to say what our peak is. I think if you look at our quarterly balance sheets over time, the quarterly that we publish, they are a reasonable representation of the shape of our balance sheet. So the end of October is not -- when we publish our [Q3], is not quite peak, but it's very close to it. I think, clearly, where that goes during the current year will depend on when we close stores because of the [release] of the inventory, and, obviously, economic circumstances.

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(inaudible) in today's climate, as they make growing concern statements, something that the Board has reviewed. And, yes; we are comfortable with our current borrowing facilities and are equipped for our current needs.

Andy Hughes - UBS - Analyst

We shouldn't necessarily link your dividend comment, then, to the sufficient headroom, because I guess the dividend would be the first thing that would take [the pain].

Walker Boyd - Signet Group plc - Finance Director

I think if we had -- if that was an immediate concern in terms of the current year, we would just declare a dividend that's unchanged from the prior year. So I think if that were the case, then clearly that would be a different question. I think we have a strong balance sheet. As I said, 21% gearing at the end of the year, fixed charge coverage 1.8, and we have adequate facilities in terms of the seasonal requirement for cash. As Terry has said, our dividend policy has always been that it will be dependent on the needs of the business, and that's a statement that we make. Again, I think in today's climate, it is just responsible for us to make sure -- to remind people of that. So we haven't -- the Board hasn't made a decision as to what its dividend will be going forward. It will be dependent on the needs of the business and the economic circumstances. So I think the issue on headroom, if you like, for this coming October, and where dividend policy is going to be going forward, are clearly two very different subjects.

Andy Hughes - UBS - Analyst

Your definition for fixed charge cover, does that include rates in the UK?

Walker Boyd - Signet Group plc - Finance Director

Yes.

Mike Dennis - Piper Jaffray - Analyst

Mike Dennis, Piper Jaffray. Could you give us some sort of a feel for the categories and how they're moving? I noticed that things like gifting in the UK and other jewelry in the US as sort of percentage of sales is declining. Can you give us a feel for, in the past year and currently, in your current trade trading, what sort of percentages categories like watches are growing at, and where you're seeing people reduce their spending in terms of add-ons or other jewelry categories, because they seem to be going down as a percentage of your business?

Terry Burman - Signet Group plc - Chief Executive

Both markets, US, UK?

Mike Dennis - Piper Jaffray - Analyst

Yes.

Terry Burman - Signet Group plc - Chief Executive

Watches in the -- take the UK first. Watches have been very strong, both in the upper end and in the moderate and fashion brands in H.Samuel, and the upper end in Ernest Jones. So we've seen a strong, very strong performance in that category. Gold has been flatish, maybe some consumer resistance to the higher price of gold which gets translated first and strongest into the gold category.

Diamonds have been a good solid performance, with continued increase in H.Samuel. In Ernest Jones, the fashion category of diamonds has been a little slow. The ring category has continued to perform well.

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And gifts at Ernest Jones -- I'm sorry -- gifts in H.Samuel, the level of decrease has moderated. But part of that is -- part of that is driven by our strategy to give it less space and less emphasis and reduce the ranges, although we do have some initiatives that we're starting to plan to see if we can bring a little more excitement to the gifts and collectibles in H.Samuel.

In terms of the US, no major shift, but the weaker category continues to be diamonds fashion jewelry. That continues to be a little weak. Of all the categories, that seems to be the most strain on it.

Mike Dennis - Piper Jaffray - Analyst

And in terms of the watches, what is that in terms of mix, change of brands, or is that sustainable or is that a big percentage like 20, 30% increase in watch there?

Terry Burman - Signet Group plc - Chief Executive

You're talking about --

Mike Dennis - Piper Jaffray - Analyst

[Watches].

Terry Burman - Signet Group plc - Chief Executive

No, I switched to the US.

Mike Dennis - Piper Jaffray - Analyst

I know you switched; I'm going back to the UK, just the beginning there. There was -- the watches had a very strong performance; I just want to get a feel for what was exactly driving that and how sustainable it is.

Walker Boyd - Signet Group plc - Finance Director

If you look at mix, when we publish our counts and you look at the product mix percentages, we're talking about plus or minus 1%. So when we say Ernest Jones diamonds with fashion weaker, that probably means in Ernest Jones, as a percentage of total sales, the diamond category is down 1% and watches are up 1%. So when you're talking -- we're talking at the margins here; we're not saying that suddenly one category goes up by 5%, the total sales in the other goes down. So when we publish our accounts, the broad -- the broad categories between watches, gold, other jewelry and diamonds, they'll be plus or minus 1%. So for example, in HS, diamond participation is up 1%; Ernest Jones is down 1%. So these are changes at the margin; they're not fundamental changes. Watches have been particularly strong in Ernest Jones with the premium brands. In the US, we would expect to see some increase in watch participation, again, measured in basis points rather than percentage points, because Jared has a higher percentage of watch sales than the mall business. So as that mix happens, and so watches have moved, I think, from 6% to 7% of US sales. But these are not dramatic changes in terms of participation.

Terry Burman - Signet Group plc - Chief Executive

And there's a fashion component to our business. There's always some -- there are always shifts like that. I don't think you should be looking at it as is this half full or half empty; we're getting some unusual surge in one product category versus another. There's always these, as Walker said, 1% shifts going on.

Seeing no further hands, we'll take this -- this is always interesting, but we'll see if we have any calls in. This is US. Are you there? Any questions on the conference line? Operator?

Operator

(OPERATOR INSTRUCTIONS). [Tian Shen], HSBC.

Tian Shen - HSBC - Analyst

My first question is can you give the size of your outstanding securitization facilities, and what's the interest rate on the facilities? That's my first question. The second question is about -- I remember probably last year, you talked about (inaudible) credit cards (inaudible) UK. [Is this still ongoing or has this been put on hold]? Third question is about -- you were just now mentioning the weak category in US is diamond. How is the competition for the online sales, because I look at one (inaudible) diamond sales actually, I mean, at this time still going quite strong. Are you seeing any loss of customers to online diamond sales? That's all. Thank you.

Terry Burman - Signet Group plc - Chief Executive

We got the second and third question. Your first question about -- you said something about facilities. Could you (multiple speakers)

Tian Shen - HSBC - Analyst

Your US (inaudible) receivables, what's your (inaudible) the size outstanding securitization facilities? And what's the interest rate on these facilities?

Walker Boyd - Signet Group plc - Finance Director

Dealing with the facilities, if you look at our total facilities, our core debt is a 10-year private placement; it's \$[880] million. And that, clearly, is our long-term debt. We also have a syndication facility which is \$390 million, a five-year facility which has got basically six or seven banks for key banks within that. If you look in our accounts, we do also have a standby conduit facility, which is a \$200 million securitization. We have not actually drawn down on that at any time. So that is, if you like, a seasonal facility. And as I said, we put it in place in the fall of last year, but have not drawn down on that. So we are not, in terms of our core borrowings, dependent on that. The rate payable on that, clearly, is variable, because it's not a long-term securitization. And it would be, certainly in terms of the margins, would be comparable, I would say, with our syndication facility.

Terry Burman - Signet Group plc - Chief Executive

Your second question was about the credit card initiative in the UK, and we're getting -- we're getting good, positive results out of that initiative, some nice increases, but it's off of a very small percentage of our total -- off of a very small percentage of our total sales. I'd just remind you that that's a third-party provided facility, or program. That is not one that we manage, nor do we have it on our balance sheet.

And your third question about sales from online retailers. Blue Nile's sales are about \$350 million, if my memory serves me correctly. So you're talking about less than 0.5% of the total US (inaudible) about 0.5%. About half -- he's auditing me. A little more than 0.5% of the total US jewelry business, maybe 0.6%. It's not that meaningful. What it does do, what the retailers like Blue Nile do -- and they're really the primary online competitor -- it increases visibility and transparency in terms of pricing, and does tend to more commoditize basic type of merchandise with a lower fashion component to it. So we do feel the pressure more on the gross margin side and the pricing visibility side than we do on the steel sales, if you will.

Tian Shen - HSBC - Analyst

Okay. Can I just follow up on one more question?

Terry Burman - Signet Group plc - Chief Executive

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Sure.

Tian Shen - HSBC - Analyst

What's your (inaudible)?

Terry Burman - Signet Group plc - Chief Executive

Sorry?

Tian Shen - HSBC - Analyst

(inaudible) you mentioned (multiple speakers)

Terry Burman - Signet Group plc - Chief Executive

Say that one more time.

Tian Shen - HSBC - Analyst

What's the size of your consignment inventory?

Walker Boyd - Signet Group plc - Finance Director

Consignment inventory in the UK is very small. In the US, which, again, it's off-balance sheet because it's (inaudible) return conditions, would be somewhere in the \$250 million mark, something like that. I need to check the exact number, but it's in that sort of area.

Tian Shen - HSBC - Analyst

Okay. That's all for me. Thank you very much.

Operator

(OPERATOR INSTRUCTIONS). As we have no further questions, I would like to turn the call back over to you for any additional or closing remarks.

Terry Burman - Signet Group plc - Chief Executive

Anybody else in the room? Any further questions? Thank you very much for your attention. Thank you very much for being here, and look forward to seeing you later in the year.

Operator

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

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