Group Chief Executive's review

Results for 2007/08

	2007/08 52 weeks $m	2006/07 53 weeks $m	Change reported %	Change at constant exchange rates on a 52 week basis[1] %	Like for like change on a 52 week basis %
Sales	**3,665.3**	3,559.2	3.0	3.2	(0.7)
Operating profit	**351.3**	416.2	(15.6)	(15.9)	
Profit before tax	**333.5**	400.8	(16.8)	(17.4)	
Basic earnings per share	**12.6c**	15.4c	(18.2)	(18.7)	
Operating margin	**9.6%**	11.7%			
ROCE	**16.8%**	22.8%			

(1) See page 37 for reconciliation of impact of exchange rates and adjustment for 53rd week in 2006/07.

2007/08 was a very demanding year for the Group, with a particularly difficult fourth quarter. Although execution within the business continued to improve, the economic environment deteriorated. The speed and extent of the change in trading conditions during the fourth quarter was unprecedented. As a result there was very limited time to align the business to reflect the change in market conditions and therefore the impact on results could not be meaningfully mitigated.

In the year to 2 February 2008 total sales rose by 3.2% at constant exchange rates on a 52 week basis (see page 37); the reported increase was 3.0% to $3,665.3 million (2006/07: $3,559.2 million). Like for like sales declined by 0.7%, the first annual decrease since 1992/93. The average exchange rate for 2007/08 was £1/$2.00 (2006/07: £1/$1.88).

Operating profit fell by 15.9% at constant exchange rates on a 52 week basis (see page 37); the reported decrease was 15.6% to $351.3 million (2006/07: $416.2 million). Operating margin was 9.6% (2006/07: 11.7%). Profit before tax was down by 17.4% at constant exchange rates on a 52 week basis (see page 37) and by 16.8% on a reported basis to $333.5 million (2006/07: $400.8 million). The tax rate was 35.5% (2006/07: 33.6%). Basic earnings per share were 12.6 cents (2006/07: 15.4 cents, the 53rd week contributing 0.1 cents in 2006/07). ROCE was 16.8% (2006/07: 22.8%).

Net debt at 2 February 2008 was $374.6 million (3 February 2007: $233.2 million). Gearing (net debt to total equity) was 20.7% (3 February 2007: 13.4%). Given that nearly all stores are leased, a further important measure of gearing is fixed charge cover, which was 1.8 times in 2007/08 (2006/07: 2.0 times). The increase in net debt before exchange adjustments was $143.6 million (2006/07: $86.4 million), reflecting the lower level of profitability, investment in new store space of $178.9 million (2006/07: $176.7 million) and distribution to shareholders of $152.9 million (2006/07: $172.1 million).

It is critical to build the long term competitive position of the business while managing short term pressure on profitability and the balance sheet during challenging economic periods. A very thorough review of the businesses on both sides of the Atlantic has been carried out following the difficult 2007 Christmas period. In consideration of the uncertain economic environment a more cautious approach to the execution of the Group's growth strategy has been adopted. Reflecting this, management focus is more on implementation and responding rapidly to changes in the marketplace, with less attention on developing longer term operational initiatives. As part of this process, actions have been identified to drive sales, protect gross margin, control costs tightly and, where appropriate, to realign the Group's cost base and inventory levels to the changed market conditions.

The Board firmly believes that a strong balance sheet, and financial flexibility, are competitive advantages. Therefore it has carefully considered the appropriate working capital levels, investment required to maintain the quality of the Group's assets and rate of space growth, as well as its distribution policy to shareholders. A strong balance sheet enables the Group to continue to invest in the business throughout the economic cycle enhancing further its strong competitive position within the marketplace.

Investment to reinforce the Group's strategic advantages remain in place, such as the expansion of Kay and Jared, the development of the rough diamond supply chain initiative, as well as the Ernest Jones refurbishment programme. Demanding investment hurdle rates continue to be applied, and as a result US net store space growth is expected to be about 5% in 2008/09 and 2009/10, which is below the 8% to 10% per annum long term target range. However, an increased level of UK store refurbishment in 2008/09 is expected to result in a broadly unchanged level of Group capital expenditure, of approximately $140 million. The anticipated reduction in working capital investment, lower tax payments and the absence of share repurchases are expected to result in a significant reduction in cash outflow during 2008/09.

US performance review (74% of Group sales)

	2007/08 52 weeks $m	2006/07 53 weeks $m	Change reported %	Change on 52 week basis[1] %	Like for like change on a 52 week basis %
Sales[2]	**2,705.7**	2,652.1	2.0	4.1	(1.7)
Operating profit	**262.2**	326.7	(19.7)	(19.6)	
Operating margin[2]	**9.7%**	12.3%			
ROCE	**14.9%**	21.5%			

(1) See page 37 for reconciliation of impact of 53rd week in 2006/07.
(2) See Group financial review for tables analysing total sales growth and movement in operating margin.

In a much more demanding trading environment the consistency of the US division's management, strategy and execution, as well as the Group's strong balance sheet were significant competitive advantages. While the US business saw an unprecedented weakening in sales in the fourth quarter and faced the impact of commodity cost increases, it continued to be a leader in setting industry operating standards. A further increase in net new space of 10% was achieved, at the top end of the target range.

Group Chief Executive's review (continued)

Like for like sales growth slowed in the first nine months of 2007/08 to 2.7%, with the gift giving events of Valentine's Day and Mother's Day being disappointing. The very important fourth quarter was particularly difficult with like for like sales declining by 8.6%, resulting in a full year decline of 1.7%. Total sales increased by 4.1% on a 52 week basis (see page 37) and by 2.0% as reported. Operating profit was down by 19.6% on a 52 week basis (see page 37) and by 19.7% as reported, to $262.2 million (2006/07: $326.7 million). The operating margin of 9.7% (2006/07: 12.3%; 12.5% on a 52 week basis) reflected expense deleverage of 190 basis points as a result of the decline in like for like sales, and the adverse impacts of additional new space (60 basis points) and change in gross margin (30 basis points). The movement in gross margin percentage was due to the significantly higher cost of gold and a greater proportion of sales from Jared, partly offset by supply chain initiatives and some limited price increases. The bad debt charge of 3.4% of total sales (2006/07: 2.8%), was at the high end of the range of the last ten years, but was largely offset by higher income associated with the receivables due to a lower monthly collection rate. The proportion of sales through the in-house credit card was 52.6% (2006/07: 51.7%).

ROCE was 14.9% (2006/07: 21.5%), reflecting the lower operating profit and investment in a 10% increase in space. The proportion of stores under six years old continued to increase and was 38% in 2007/08 compared to 32% in 2006/07. The higher proportion of immature stores constrains ROCE in the short term, but increases operating profit and drives future growth.

The division continued to implement its proven strategy and the performance of the business against these criteria is set out below:

Strategy: To achieve sector leading performance standards
In 2007/08 the division increased total sales by 4.1% (52 week basis, see page 37), and, despite the comparative weakness of the middle mass market, performed broadly in line with the total US jewellery market which grew by 4.0% to $64.7 billion in calendar 2007 (2006: $62.2 billion; source: US Department of Commerce). The Group's share of the speciality jewellery market remained at 8.8%. In 1997/98, the division accounted for 4.8% of speciality jewellery sales and 7.0% in 2002/03.

Over the five year period ended on 2 February 2008 the division's operating margin averaged 12.0% and Earnings Before Interest and Tax ("EBIT") / Year End Total Assets ratio was 14.9%. Jewelers of America reported that the typical speciality retail jeweller was achieving an average operating margin of 5.4% and a 7.7% EBIT / Year End Total Assets ratio over the five years to 31 December 2006, being the last year for which figures have been published. While 2007/08 was difficult, over the last five years the Group's total sales have increased by 56.4% and operating profit by 25.8%.

Strategy: To improve store productivity
The key driver of the division's comparatively high operating margins and return on assets is store productivity, which is well above that of the industry as a whole. While the Group's strategy is to increase store productivity, there was a decline in 2007/08, reflecting the fall in like for like sales and an increase in the proportion of immature stores under six years old. Over the last five years the sales per store for Kay and Jared have increased to $1.71 million from $1.53 million and to $5.34 million from $4.57 million respectively. The regional brands achieved sales per store of $1.34 million in 2007/08 with the difference in performance between Kay and the regional brands continuing to reflect the benefit of national television advertising.

Strategy: To grow new store space
The Group has strict criteria for investment which have been consistently applied. Over the last five years net new store space of 10% per annum has required a total investment of some $700 million in fixed and working capital. Appraisal reviews show that, in aggregate, investment returns continue to exceed the Group's targeted 20% internal rate of return over five years. In 2007/08, net new store space grew by 10% (2006/07: 11%). Over 80% of the growth was outside traditional malls in 2007/08 and at 2 February 2008 about 40% of store space was off-mall. The table below sets out the store numbers, net new openings and the potential number of stores by chain and format:

Store numbers	3 February 2007	Net openings 2007/08	**2 February 2008**	Expected net openings 2008/09	Long term potential
Kay					
Mall	772	17	**789**	6	850+
Off-mall	52	40	**92**	19	500+
Outlet	5	5	**10**	8	50-100
Metropolitan	3	nil	**3**	nil	c.30
	832	62	**894**	33	1,430+
Regionals	341	10	**351**	(14)	c.700
Jared	135	19	**154**	17	c.300
Total	1,308	91	**1,399**	36	2,430+

Real estate investment
In 2007/08, fixed capital investment was $111.1 million (2006/07: $101.1 million), including some $60.1 million (2006/07: $57.3 million) related to new store space. In 2008/09, revisions to sales projections reflecting the challenging trading conditions, will result in fewer opportunities that meet the Group's investment criteria. Therefore, in 2008/09, space growth is expected to be about 5%, net of about 30 store closures (2007/08: 17). Over the longer term the US division continues to have the potential to almost double its size. This can be achieved through organic expansion within the existing formats for Kay and Jared. For the regional brands to achieve this potential would require one or more acquisitions, and such activity is not expected to occur imminently. Recent and planned investment in the store portfolio, both fixed and working capital, is set out below:

	Planned 2008/09 $m	**2007/08 $m**	2006/07 $m	2005/06 $m
Total new stores				
Fixed capital investment	45	**60**	57	45
Working capital investment	90	**119**	119	96
Total investment	135	**179**	176	141
Other store fixed capital investment	24	**28**	30	28
Total store investment	159	**207**	206	169

Fixed capital expenditure in 2008/09 is planned to decrease to about $90 million, including circa $45 million related to new stores. The investment in working capital, that is inventory and receivables, associated with gross space growth amounted to some $119 million in 2007/08 and is expected to be significantly lower at about $90 million in 2008/09. 62 stores were refurbished or relocated (2006/07: 59), with some 51 planned for 2008/09.

Operating initiatives in 2008/09

In the current challenging environment the US business has taken action to control costs tightly. Store staff hours and advertising expenditure have been realigned, where possible, to reflect current sales expectations. Staff training and development continues to be a priority, as does investment to enhance in-store procedures to improve customer service and productivity. Staffing levels elsewhere have been frozen, despite the growth in store numbers, and a range of other costs have been cut.

Consumers' financial positions continue to deteriorate which may lead to a further increase in the bad debt charge, although this is expected to be somewhat offset by increased income from the credit portfolio. Consequently credit authorisation criteria continue to be reviewed and outstanding balances are very closely monitored with prompt action being taken in response to changes in performance. In addition, further investment in collection systems is taking place.

The development of exclusive ranges, such as the Leo Diamond, the Peerless Diamond and the Hearts Desire collection and the expansion of the Le Vian selection, continue to help differentiate the division in the marketplace and to increase average transaction value. The 2007/08 year end inventory was above plan by about $20 million due to the difficult fourth quarter and future purchases are being strictly controlled. Actions to realign inventory to current sales levels have been taken and it is anticipated that this will be achieved by June 2008.

In 2006/07 and 2007/08 substantial increases in gold and platinum costs had an impact on the entire US jewellery sector, and were largely not passed on to consumers. After careful consideration and planning it was decided to increase prices covering a broad merchandise range, including both basic and fashion products, following Valentine's Day 2008. The Group's pricing strategy is to be competitive over the long term; however the price changes have resulted in a departure from this position in the short term, although an increasing number of speciality jewellers are also increasing prices. While the impact of the price increases will only be fully apparent in the second quarter of 2008/09, the early results are encouraging.

Advertising expenditure as a percentage of sales is being realigned to nearer historic levels, in addition the cadence of promotional activity is being increased and made more responsive to market conditions. The Kay website will be further developed and an e-commerce facility on the Jared website is planned to be introduced in the second half of 2008/09.

UK performance review (26% of Group sales)

	2007/08 52 weeks $m	2006/07 53 weeks $m	Change reported %	Change at constant exchange rates on a 52 week basis[1] %	Like for like change on a 52 week basis %
Sales: H.Samuel	**513.4**	490.3	4.7	(0.1)	1.3
Ernest Jones	**438.8**	409.1	7.3	2.3	2.9
Other	**7.4**	7.7	(3.9)	(7.5)	
Total[2]	**959.6**	907.1	5.8	0.9	2.0
Operating profit	**105.1**	103.4	1.6	(1.3)	
Operating margin[2]	**11.0%**	11.4%			
ROCE	**29.9%**	32.7%			

(1) See page 37 for reconciliation of impact of exchange rates and adjustment for impact of 53rd week in 2006/07.
(2) See Group financial review for tables analysing total sales growth and movement in operating margin.

In a tough UK retail marketplace like for like sales were ahead of last year and operating margins, cash flow and ROCE remained strong. The business achieved further improvements in the key areas of execution, particularly customer service.

Like for like sales growth was 2.0%, an encouraging performance in an increasingly challenging marketplace. Growth in the first nine months of 2007/08 was stronger than last year at 4.7%, but became more difficult in the fourth quarter with like for like sales declining by 1.7%. Total sales increased by 0.9% at constant exchange rates on a 52 week basis (see page 37) and by 5.8% on a reported basis to $959.6 million (2006/07: $907.1 million).

Operating profit was little changed at constant exchange rates on a 52 week basis (see page 37); the reported increase was 1.6% to $105.1 million (2006/07: $103.4 million). Operating margin was down 40 basis points on the prior year reflecting expense leverage of 40 basis points from the small increase in like for like sales combined with tight control of costs, an adverse movement in gross margin percentage of 60 basis points and the benefit to 2006/07 of the 53rd week (adverse 20 basis points). The movement in gross margin was primarily caused by changes in mix due to the strong performance of the watch category, some impact from commodity costs and an increased proportion of sales from Ernest Jones. ROCE was 29.9% (2006/07: 32.7%), primarily reflecting the impact of the 53rd week in 2006/07 and a slight increase in capital employed.

Group Chief Executive's review (continued)

Further progress was made in implementing the division's successful strategy and its performance against those criteria are set out below:

Strategy: To achieve sector leading performance standards
The total UK jewellery market was unchanged at £4.5 billion in calendar 2007 including VAT (source: Office of National Statistics); and the division's market share was similar to last year at 12.1%. In 2007/08, the division's operating margin was 11.0% and its EBIT / Year End Total Assets ratio was 21.2%. In the year to 31 March 2007, the last year for which figures are available, the next five largest speciality retail jewellers had an average operating margin of 5.7% and a 6.4% EBIT / Year End Total Assets ratio.

Strategy: To improve store productivity
Store productivity increased in both H.Samuel and Ernest Jones in 2007/08 to £0.72 million from £0.70 million and to £1.11 million from £1.08 million respectively. This reflected divisional like for like sales growth of 2.0% and, in H.Samuel, a continuing reduction of the store base to focus on stores in larger centres that provide an opportunity to achieve a greater ROCE. With average selling space of about 870 square feet per store, Ernest Jones achieved the highest sales density of any Signet brand.

Real estate and investment

During 2007/08, 27 stores were refurbished or relocated. At the year end, 282 locations, mostly H.Samuel, traded in the customer oriented format, accounting for some 50% of the UK division's sales. At 2 February 2008, there were 359 H.Samuel and 204 Ernest Jones branches (3 February 2007: 375 and 206 respectively).

	2007/08	2006/07	2005/06
H.Samuel stores			
Openings	**1**	–	3
Closures	**(17)**	(11)	(15)
Year end	**359**	375	386
Ernest Jones stores			
Openings	**–**	1	5
Closures	**(2)**	(2)	(2)
Year end	**204**	206	207
Total stores at year end	**563**	581	593

The level of store capital expenditure during 2007/08 was £9 million (2006/07: £8 million) reflecting the phasing of the refurbishment cycle. In 2008/09 it is planned to roll out up to 49 sites, including new locations, in the enhanced Ernest Jones store design, which produced very encouraging results when tested in the second half of 2007/08. In addition, up to a further 25 H.Samuel locations are expected to begin trading in the more customer oriented format by Christmas 2008. As a result store capital expenditure is expected to increase to some £25 million in 2008/09. Recent and planned investment in the portfolio is set out below:

	Planned 2008/09	**2007/08**	2006/07	2005/06
Store refurbishments and relocations	69	**27**	28	78
New H.Samuel stores	2	**1**	–	3
New Ernest Jones stores	3	**–**	1	5
Store fixed capital investment	£25m	**£9m**	£8m	£22m

Operating initiatives for 2008/09

In the current uncertain environment, the UK business will continue to manage costs, inventory and gross margin very closely. While the impact of commodity cost increases has been less than in the US due to the weakness of the dollar, price increases have been implemented. The successful initiative to drive footfall by taking advantage of the scale of the business, while maintaining gross margin, through key volume lines will continue to be developed. The diamond selection, particularly in exclusive and value ranges, is being enhanced. Mixed metal ranges are being expanded and new merchandise is being tested more efficiently. In the watch category, relationships with the leading agencies continue to be a priority.

Additional initiatives continue to be introduced to raise customer service standards even further, including extension of the customer satisfaction index to all sites and enhancements to training materials on product knowledge and selling skills. New store communication and executional tools are being tested.

Advertising expenditure will be adjusted to reflect the return on investment being achieved. The "H.Samuel helps you say it better" and "Only at Ernest Jones" marketing propositions are planned to be developed further and the e-commerce websites for both brands are expected to be improved.

Terry Burman
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