

# UK operating review

## Brand reviews

### H.Samuel

#### Introduction

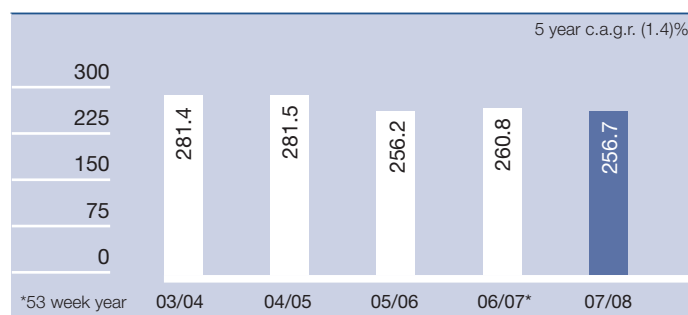
H.Samuel accounted for 14% of Group sales in 2007/08 (2006/07: 14%), and is the largest speciality retail jewellery brand in the UK with a 6.5% share of the total jewellery market. It serves the core middle market and its customers typically have a household income of between £15,000 and £40,000. The brand has nearly 150 years of jewellery heritage. It sells a broad range of gold and silver jewellery, an increasing proportion of diamond merchandise and a wide selection of watches, including Accurist, Citizen, DKNY, Fossil, Rotary, Seiko and Sekonda. It also sells an increasingly focused range of gifts and collectables such as Nao and Swarovski.

H.Samuel had 359 stores at 2 February 2008 (3 February 2007: 375) and is represented in nearly all large and most medium sized shopping centres with the focus increasingly being on larger centres. An e-commerce capability was added to hsamuel.co.uk in September 2005 and it is the most visited UK speciality jewellery website (source: Hitwise).

#### 2007/08

H.Samuel sales were £256.7 million (2006/07: £260.8 million). The average retail price of merchandise sold in H.Samuel during 2007/08 was £44 (2006/07: £42) and the average retail price of items sold has increased at a compound annual growth rate of 6.2% over the last five years. The sales per store increased to £722,000 (2006/07: £695,000 on a 53 week basis) and have increased at a compound annual growth rate of 1.3% over the last five years.

### H.Samuel 5 year sales, £m



### H.Samuel store data

	2007/08	2006/07	2002/03
<b>Number of stores:</b>			
Opened during year	1	–	4
Closed during year	(17)	(11)	(8)
Open at end of year	359	375	418
Percentage increase in like for like sales	1.3%	0.7%	2.6%
Average sales per store in thousands (exc. VAT) <sup>(1)</sup>	£722	£695 <sup>(2)</sup>	£677

(1) Including only stores operated for the full financial year.  
(2) 53 week year.

## UK marketplace

In calendar 2007 the size of the total UK market for fine jewellery, costume jewellery and watches was estimated by the Office for National Statistics (“ONS”) to have been £4.5 billion (\$9.0 billion) (including VAT of 17.5%), (2006: £4.5 billion). The ONS figure for market size replaces previous figures for market size which were based on management estimates and market research carried out by Key Note. While the ONS figure has been adopted, its reliability is uncertain. The jewellery market grew at an estimated compound rate of 4.7% per annum from 1997 to 2004. It declined by 4.0% in 2005, when the retail sector as a whole experienced the sharpest deterioration in trading conditions since 1991, with the jewellery sector being particularly affected. In 2006 the UK jewellery market returned to growth while 2007 was unchanged. Per capita spend on jewellery in the UK remains at approximately half of the level of the US. The market includes speciality retail jewellers and non-speciality jewellery retailers, such as mail order catalogues, catalogue showrooms and jewellery departments in department stores.

The UK retail jewellery market is very fragmented and competitive, with a substantial number of independent speciality jewellery retailers. Management believes there are just over 7,000 speciality retail jewellery stores in the UK.

Based on surveys, management believes that customers are attracted to H.Samuel because of its strong brand appeal as a speciality jeweller, that is differentiated by its customer service standards and staff knowledge. Ernest Jones attracts customers as a result of its diamond and watch expertise, exclusive and up to date merchandise and knowledgeable staff.

#### Market structure

In the middle market H.Samuel competes with a large number of independent jewellers, with only one having more than 100 stores. Some competition at the lower end of the H.Samuel product range also comes from a catalogue showroom operator, and discount jewellery retailers and supermarkets.

In the upper middle market Ernest Jones competes with independent speciality retailers and a limited number of other upper middle market jewellery brands, the largest three of which had 187, 62 and 31 stores respectively at 2 February 2008.

During 2007/08, television advertising, using the theme “H.Samuel helps you say it better”, was successfully developed. An H.Samuel store credit card was tested and launched. Staff training remained a priority and about 40% of H.Samuel staff have an externally recognised jewellery industry qualification.

### Customer service

Customer service is an increasingly key point of differentiation for H.Samuel. Historically the brand's customers self selected merchandise from window displays and primarily required a ‘cash and wrap’ service. Sales associates in H.Samuel now need an increased level of product knowledge and selling skills as a growing proportion of sales are of products, such as diamond jewellery that require much higher levels of customer service. Therefore a priority in recent years has been to improve the training process within the UK division (see page 23).

### Merchandising

In 2007/08 diamond jewellery accounted for 22% of H.Samuel's merchandise mix, up from 16% in 2002/03. This helped increase the average unit selling price to £44 from £33 over that period. Within the diamond category the average selling price increased to £201 (2002/03: £179). Since 2002/03, sales of gift and other items have declined to 12% of the total from 19% (see table below).

Merchandising initiatives to further increase the differentiation of H.Samuel stores and to reinforce the brand perception as a speciality jeweller continued, for example the launch of the Julien Macdonald range and the development of exclusive merchandise such as the Forever Diamond range. Key volume items were again used to drive footfall. These items take advantage of H.Samuel's buying scale and offer consumers an attractive price while achieving a satisfactory gross margin and are promoted in marketing and point of sales material. As in 2006/07 a more targeted approach to promotional activity was beneficial during 2007/08.

### H.Samuel merchandise mix (excluding repairs, warranty and other miscellaneous sales)

	2007/08	2006/07	2002/03
Gold jewellery	31%	31%	32%
Watches	25%	24%	24%
Diamond jewellery	22%	21%	16%
Other jewellery	10%	10%	9%
Gifts and other	12%	14%	19%
Average selling price	£44	£42	£33

### Marketing

Over Christmas H.Samuel used the “H.Samuel helps you say it better” television advertising supplemented by advertising in national newspapers and catalogue distributions. For the remainder of the year a series of themed catalogues displayed in stores, mailed directly to targeted customers and distributed in newspapers were the primary form of marketing. During 2007/08 co-ordination of the

different forms of marketing and promotion was improved. The H.Samuel website has been transactional since 2005 and its performance has been encouraging, although its sales are relatively small in the context of the division as a whole.

### Store design

The H.Samuel store portfolio is nearing the end of a radical refit that started seven years ago. Previous to that, stores were designed for a shopper who made a choice from a window display. The changed format is designed to facilitate the sale of merchandise with a higher average selling price, particularly diamonds, and therefore allows an increased focus on customer service and greater convenience in presenting merchandise to customers. The clear internal layout by department enhances the ability to provide appropriately trained specialist staff in each area.

The format uses low level displays, which act as service counters for jewellery, particularly diamond ranges; wall display cases are used predominantly for watches, gifts and lower value jewellery items. The refitted stores are also much more open and inviting. While the design was based on the Group's US experience, it was adapted to H.Samuel's merchandising and customer requirements.

Further evolutionary changes to the design have been made during the refit programme. These include improved presentation of jewellery, particularly in wall showcases; more clearly displayed branded merchandise such as watches; and more effective use of in-store signage.

### Real estate

H.Samuel has a seven year store refurbishment cycle. In 2007/08 16 refits or resites were completed (2006/07: 28 including two in the traditional format). At 2 February 2008 234 stores, accounting for just over 70% of sales, traded in the more customer oriented store design.

Some 23 refits and resites are planned in 2008/09. The conversion programme to a more customer oriented format for H.Samuel is anticipated to be completed in 2009/10. Thereafter, the cost of store refurbishment is expected to reduce significantly as structural work, such as the move away from window based displays, will be much lower.

H.Samuel is increasingly focused on bigger stores, in larger shopping destinations, where it is better able to offer more specialist customer service, a wider range of jewellery and benefit from the more customer oriented format. This reflects the changing shopping patterns of customers. The number of H.Samuel stores in smaller markets is therefore likely to decline as leases expire or suitable real estate transactions become available. Over the last five years there has been a reduction of 59 stores.

## Ernest Jones

### Introduction

Ernest Jones accounted for 12% of Group sales in 2007/08 (2006/07: 11%), and is the second largest speciality retail jewellery brand in the UK with a market share of 5.6% of the total jewellery market. It serves the upper middle market and its customers typically

## UK operating review (continued)

have a household income of between £30,000 and £50,000. It sells a broad range of diamond and gold jewellery as well as prestige watches such as Breitling, Cartier, Longines, Omega, Rado, Raymond Weil, Rolex and Tag Heuer. It also sells contemporary fashion watches such as Burberry, DKNY, Emporio Armani, Gucci, Hugo Boss and a range of traditional watches including Accurist, Rotary, Seiko and Tissot.

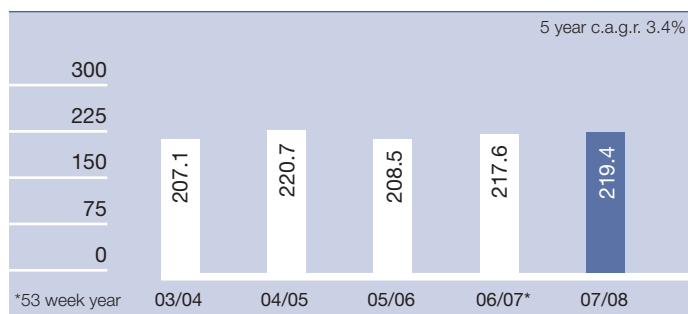
Ernest Jones had 204 stores at 2 February 2008 (3 February 2007: 206) and is represented in nearly all large shopping centres. An e-commerce capability was added to [ernestjones.co.uk](http://ernestjones.co.uk) in September 2006 and it is the second most visited UK speciality jewellery website (source: Hitwise).

Where local market size and merchandise considerations allow, a two-site strategy is followed using the Leslie Davis trading name. While having a similar customer profile to Ernest Jones, Leslie Davis is differentiated by a greater emphasis on fashion brands and the store design. There were 16 Leslie Davis stores at 2 February 2008 (3 February 2007: 16).

### 2007/08

Ernest Jones sales were £219.4 million (2006/07: £217.6 million), with watches showing good growth but the diamond jewellery performance was disappointing. Sales per store improved in 2007/08

### Ernest Jones 5 year sales, £m



### Ernest Jones store data<sup>(1)</sup>

	2007/08	2006/07	2002/03
<b>Number of stores:</b>			
Opened during year	–	1	8
Closed during year	(2)	(2)	–
Open at end of year	204	206	192
Percentage increase in like for like sales	2.9%	1.7%	9.4%
Average sales per store in thousands (exc. VAT) <sup>(2)</sup>	£1,105	£1,079 <sup>(3)</sup>	£1,030

(1) Including Leslie Davis stores.

(2) Including only stores operated for the full financial year.

(3) 53 week year.

to £1,105,000 (2006/07: £1,079,000 on a 53 week basis) and have increased at a compound annual growth rate of 1.4% over the last five years.

During 2007/08 an enhanced store design was successfully tested, a new marketing theme for the brand was developed and a store branded credit card was launched. The quality of staff training was further improved, with over 45% of Ernest Jones staff having gained an externally recognised jewellery industry qualification. A specially designed diamond ring for Christmas was a notable success.

### Customer service

As over two thirds of Ernest Jones sales mix consists of diamonds and watches, store staff provide a high level of customer service and have detailed product knowledge. An increasing proportion of staff have undertaken training provided by the division in conjunction with the International Gemological Institute (“IGI”) or the British Horological Institute (“BHI”). The enhanced store design that was tested in 2007/08 provided a more appropriate sales environment for diamond jewellery, in particular rings, and watches.

### Merchandising

In 2007/08 diamond jewellery accounted for 34% of Ernest Jones’ merchandise mix similar to the level in 2002/03. The average retail price of merchandise sold in Ernest Jones in 2007/08 was £180 (2006/07: £163) and has increased at a compound annual growth rate of 6.7% over the last five years. In 2007/08 within the diamond category the average selling price increased to £440 (2006/07: £413). The Leo Diamond range, exclusive to Ernest Jones in the UK, was further developed in 2007/08. Watch participation in the merchandise mix increased to 33% and Ernest Jones continues to develop its relationships with the leading watch distributors.

### Ernest Jones merchandise mix (excluding repairs, warranty and other miscellaneous sales)

	2007/08	2006/07	2002/03
Gold jewellery	25%	25%	25%
Watches	33%	31%	33%
Diamond jewellery	34%	35%	33%
Other jewellery	6%	6%	5%
Gifts and other	2%	3%	4%
Average selling price	£180	£163	£130

### Marketing

During 2007/08 a new marketing proposition “Only at Ernest Jones” was developed and tested. This is intended to help differentiate the brand in the marketplace and emphasises the exclusive merchandise that is available, such as the Leo Diamond, the Christmas products and certain watch designs. It is intended to develop this positioning further in 2008/09.

For most of the year the primary marketing and advertising medium employed by Ernest Jones is a series of catalogues distributed by mail and as inserts in newspapers and magazines. They are also available in all stores. In 2007/08 the quality of catalogues continued to be improved and their distribution better targeted. Increasing use is also being made of customer relationship marketing and it is planned that this will be developed further in 2008/09. There is also an Ernest Jones website, which was made transactional in September 2006. Its performance is encouraging, but its sales remain relatively small within a divisional context.

In recent years Ernest Jones has tested the effectiveness of television advertising. During Christmas 2007 a new television commercial broadcast in areas covering about 60% of the store base. The results of the trial continue to be analysed.

### Store design

A more open, customer oriented store design has also been implemented for Ernest Jones. Ahead of a major refurbishment programme, an enhanced more contemporary design was developed and tested in late 2007/08. The design increased the differentiation of the brand by giving greater prominence to the Ernest Jones brand and the watch agencies, as well as providing an improved environment for selling diamond jewellery. The early results of this design have been encouraging.

### Real estate

Ernest Jones' normal refurbishment cycle is ten years and the majority of its stores are due for refit in the period 2008/09 to 2011/12 in the enhanced design. During 2007/08, 11 refits and resites were completed, including three Leslie Davis stores. At 2 February 2008 48 stores, accounting for a little over 20% of sales, traded in the more customer oriented format (3 February 2007: 38). 46 refits and resites are planned for 2008/09.

The number of Ernest Jones stores has been broadly stable over the last five years and additional sites will be added depending on the availability of suitable sites and prestige watch agencies.

## Functional reviews

### Customer service and human resources

#### Introduction

Management regards customer service as an essential element in the success of its business, and the division's scale enables it to invest in industry-leading training. The Signet Jewellery Academy, a multi-year programme and framework for training and developing standards of capability, is operated for all store staff. It utilises a training system developed by the division called the "Amazing Customer Experience", also known as "ACE".

#### 2007/08

The division further developed its ACE training programme and a complementary programme for the division's head office has been

implemented. In addition, the training programme was more closely co-ordinated with merchandising initiatives and marketing events. An ACE Index customer feedback survey, which gives a more accurate reflection of customers' experiences, has been trialled and is being implemented.

#### Training

The ACE training programme was introduced in 2006/07 and was further developed during 2007/08. ACE is a flexible programme consisting of six elements that better enable store staff to meet the needs of customers. In addition to the normal training programme one day ACE workshops were introduced in 2007/08. This programme will be expanded in 2008/09. All store personnel have daily performance targets. They are given training and weekly feedback on their performance from store and field management to help them achieve these targets. Training in management skills is provided to all tiers of store operations management to support the store associate training programme and to build general management skills.

The division's continuing programme to improve the training of its staff is reflected in the number of staff that have now passed the Jewellery Education & Training ("JET") Level 1 qualification accredited by the National Association of Goldsmiths ("NAG"). In total 1,299 sales associates and 1,331 store managers and assistant store managers (representing 83% of store management) have achieved this qualification and the pass rate in 2007/08 was 91%. Signet now employs nearly half of all JET Level 1 qualified people that work in the UK retail jewellery industry.

In addition the division has established award winning workshops run in partnership with the IGI to increase product knowledge in the diamond category. In addition, during 2007/08 a partnership was developed with the BHI to deliver workshops that increase service levels in store and help drive the sales performance of the watch category. These courses form part of the training programme for staff hoping to achieve a JET Level 2 qualification from NAG. This qualification is particularly relevant for Ernest Jones staff.

#### Recruitment and retention

The division has achieved a further fall in staff turnover and at store management level it is at its lowest level for many years. This contributes to improved customer service, employee engagement and store performance levels. Management believes that improved recruitment procedures, better training programmes, the continuing development of the commission scheme, career prospects and its response to the annual staff opinion survey, have contributed to this.

Recruitment procedures, including online facilities, continue to improve the suitability of new store personnel, helping to ensure that they meet key basic requirements and are motivated to work within a jewellery store environment. Field and human resources management are responsible for the recruitment, review, training and development of sales staff, thereby ensuring consistency in operating standards and procedures throughout the business. All new store staff receive a structured induction programme that covers store operations, product knowledge and customer service. A financial reward is received upon completion.

## UK operating review (continued)

A commission-based remuneration programme first implemented in 2005/06 was developed further during 2007/08. The level of commission paid is dependent on a combination of store and individual performance.

### Promotion

The division's preferred policy is to promote store management from within the business and aim for 80% of appointments to be internal applicants. Each chain always has a number of sales staff who are qualified to advance to store management level, thus assuring the availability of newly trained managers familiar with the division's operating standards and procedures.

### Store support

In order to increase staff selling time and to improve efficiency, operating procedures are routinely reviewed to identify opportunities to enhance customer service and reduce in-store administrative tasks. The Signet intranet, which was upgraded during the year, provides a computer-based platform for improved communication between stores and head office, with sales floor and back office administrative functions being simplified and standardised through this medium. A two year programme to replace and upgrade store EPOS equipment was begun during the year. Part of the upgrade included access to the internet to allow online credit authorisations for the new branded credit card.

### Head office

Management believes that successful recruitment, training and retention of divisional head office staff is important. Accordingly, structured recruitment, training and performance management systems are in place. Internal career advancement is supported by succession planning. Teamwork and service to the stores are encouraged through a performance bonus plan for head office staff, which is based on the division's results. The implementation of a programme to drive continuous improvement, cross functional alignment and customer-focused decision making was introduced in 2007/08 and will continue through 2008/09. The programme includes back-to-the-shop-floor exercises, development workshops and e-learning.

## Merchandising and purchasing

### Introduction

Management believes that the division's leading position in the UK jewellery sector is an advantage when sourcing merchandise, enabling delivery of better value to the customer. An example of this is its capacity to contract with jewellery manufacturers to assemble products, utilising directly sourced gold and diamonds. In addition, the division has the scale to utilise sophisticated merchandising systems to test, track, forecast and respond to consumer preferences.

The division retails an extensive range of merchandise including gold and silver jewellery, watches, diamond and gemstone set jewellery and gifts. As with other UK speciality retail jewellers, most gold jewellery sold is 9 carat, although sales of 18 carat gold jewellery and platinum have been increasing.

### 2007/08

The division continued an initiative to increase the differentiation of H.Samuel and Ernest Jones in their respective marketplaces by increasing the range of exclusive merchandise stocked and by the greater use of collections. In addition the presentation of merchandise was improved by the development of new displays and the reduction in product densities through the rationalisation of merchandise ranges. In 2007/08 diamond jewellery accounted for 28% of total Signet UK merchandise mix versus 23% in 2002/03.

### Other sales

Repair services account for nearly all the other sales made by the UK division and account for less than 10% of the division's sales. Third party warranties are also sold with only the commission earned being recognised in sales.

### UK division merchandise mix (excluding repairs, warranty and other miscellaneous sales)

	2007/08	2006/07	2002/03
Gold jewellery	28%	28%	29%
Watches	29%	28%	28%
Diamond jewellery	28%	28%	23%
Other jewellery	8%	8%	7%
Gifts	7%	8%	13%
Average selling price	£68	£63	£48

### Suppliers

Merchandise is purchased from a range of suppliers and manufacturers and economies of scale and buying power continued to be achieved by combining the purchases of H.Samuel and Ernest Jones. In 2007/08 the five largest of these, (four watch and one jewellery supplier), together accounted for approximately 26% of total UK division purchases, with the largest accounting for approximately 7%. Only a small percentage of merchandise is purchased on consignment (see note 13 on page 99).

### Direct sourcing

The UK division also employs contract manufacturers for approximately 27% of the diamond merchandise sold, thereby achieving cost savings. Some 20% of the UK business' gold jewellery is manufactured on a contract basis through a buying office in Vicenza, Italy.

### Merchandising

Both H.Samuel and Ernest Jones employ experienced buyers who concentrate on product development, sourcing and supplier management appropriate to their particular needs. Merchandising teams work in conjunction with the buyers and focus on assortment planning, branch grading, repeat orders, inventory levels and margin management. Product category reviews are regularly carried out with a focus on increasing potential gross margin return on investment. Rigorous test marketing procedures are used to trial products, and their subsequent distribution is made strictly against rates of sale.

Each store is assigned a range of merchandise that reflects local buying patterns. Display equipment and layouts are constantly reviewed and updated, and new display formats and units that draw upon the US division's experience have been implemented.

## Marketing and advertising

The UK division has strong and well established brands and leverages them with advertising (television, print and online), catalogues and the development of customer relationship marketing techniques. Few of its competitors have sufficient scale to utilise all these marketing methods successfully. Marketing campaigns are designed to reinforce and develop further the distinct brand identities. Both campaigns aim to expand the overall customer base and improve customer loyalty. Gross expenditure on marketing and advertising was £14.6 million (2006/07: £14.6 million) and amounted to 3.1% of sales in 2007/08 (2006/07: 3.1%).

## Real estate

Strict criteria are followed when evaluating real estate investment and management believes that the quality of its store portfolio is superior to that of many of its competitors. Nearly all the division's stores are leased and the strength of the Group's balance sheet and the division's trading record makes it an attractive tenant.

The level of store capital expenditure was £9 million (2006/07: £8 million), the increase reflecting the phasing of the normal store refurbishment cycle and investment in information technology. The level of store refit is planned to be at a significantly higher level in 2008/09 due to the Ernest Jones store refurbishment cycle, and store capital expenditure is expected to increase to up to £25 million (2007/08: £9 million). The typical cost of a store refit for H.Samuel is between £200,000 and £250,000 and for Ernest Jones £250,000 to £350,000.

Recent and planned investment in the store portfolio is set out below:

### Store investment

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

## Insurance loss replacement business

While nearly all the UK division's sales are made directly to the consumer, management believes that Signet is the leading UK jewellery retailer in the insurance loss replacement business. This involves the settlement of insurance claims by product replacement through jewellery stores rather than by cash settlements from the insurance company. A lower gross margin is earned on these transactions than on sales to individual customers. However, the division benefits from the resulting higher level of sales, greater customer traffic in the

stores and the opportunity to create and build relationships with new customers. Given its nationwide store portfolio, breadth of product range and ability to invest in systems to support the business, the division has benefited from insurance companies settling claims in this manner. In 2007/08 the proportion of sales generated from the insurance loss replacement business again increased.

## Credit operations

Following a successful test in early 2007/08, the division rolled out a third party own-label credit card programme in time for the Christmas trading season. The roll out was supported by staff training. Drawing on the experience of the US division, the card offers customers a number of different credit options depending on transaction value and customer preference. The card is administered and funded by, and default risk resides with, a third party. The division pays a fee for this facility based on a percentage of the transaction value which varies dependent on which credit option is taken by the customer.

Before the launch of this initiative customers were offered an interest-free credit programme for purchases above a particular price. This offer was administered and funded by the same third party on the same basis as the new own label card. In 2007/08 approximately 3% of the division's sales value was through one or other of these credit programmes (2006/07: 2%).

Bank credit card sales are treated as cash transactions and accounted for approximately 30% of sales during 2007/08 (2006/07: 29%).

## Management tools and communications

EPOS equipment, retail management systems, purchase order management systems and merchandise planning processes are in place to support financial management, inventory planning and control, purchasing, merchandising, replenishment and distribution and can ensure replacement within 24 hours of any merchandise sold. The fourth phase of an electronic "Business To Business" communications project, developed to improve the efficiency and effectiveness of dealing with suppliers, was implemented in 2007/08.

A perpetual inventory process allows store managers to check stock by product category. These systems are designed to assist control of shrinkage, fraud prevention, financial analysis of retail operations, merchandising and inventory control.

## Regulation

Various laws and regulations affect Signet's UK operations. These cover areas such as consumer protection, consumer credit, data protection, health and safety, waste disposal, employment legislation and planning and development standards. Management monitors changes in these laws with a view to ensuring that its practices comply with legal requirements.