Group financial review

for the 52 weeks ended 2 February 2008

	2007/08 $m	2007/08 %	2006/07* $m	2006/07 %	2005/06 $m	2005/06 %
Sales						
US	**2,705.7**	**73.8**	2,652.1	74.5	2,308.8	73.2
UK	**959.6**	**26.2**	907.1	25.5	845.3	26.8
Total	**3,665.3**	**100.0**	3,559.2	100.0	3,154.1	100.0
Operating profit						
US	**262.2**	**78.6**	326.7	81.5	300.7	83.4
UK	**105.1**	**31.5**	103.4	25.8	88.4	24.5
Group function	**(16.0)**	**(4.8)**	(13.9)	(3.5)	(14.4)	(4.0)
	351.3	**105.3**	416.2	103.8	374.7	103.9
Net finance charge	**(17.8)**	**(5.3)**	(15.4)	(3.8)	(14.0)	(3.9)
Profit before tax	**333.5**	**100.0**	400.8	100.0	360.7	100.0

* 53 week year.

Reporting currency

Over 70% of the Group's sales, operating profit and net assets, including predominantly all of its borrowings, are denominated in US dollars. Therefore from the start of its fiscal year on 4 February 2007 the Group commenced reporting in US dollars (including comparatives and the five year record), to better reflect its underlying performance. The functional currency of the Company changed to US dollars on 5 February 2007.

Introduction

The Group's sales are seasonal with the first and second quarter both normally slightly more than 20% of annual sales, the third quarter a little under 20% and the fourth quarter accounting for about 40% of sales, with December being by far the most important month of the year. Due to operating leverage the operating profit of the Group is even more seasonal, with nearly all the UK division's, and a little over 50% of the US division's, operating profit occurring in the fourth quarter. Group costs occur broadly evenly during the year, while net financing costs are higher in the second half of the year reflecting the peak in working capital requirements ahead of the key Christmas trading period.

The key drivers of operating profitability are the:

- rate of sales growth;
- balance between like for like sales growth and sales from new store space;
- achieved gross margin;
- level of cost increases experienced by the Group; and
- movements in the US dollar to pound sterling exchange rate, as the minority of the Group's profits are generated in the UK and the Group has reported its results in US dollars.

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

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

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

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

Signet's target of 8% – 10% net new store space growth in the US, with a slight decline in space in the UK, means lower like for like sales growth is required in the UK than in the US to maintain operating margin. As the planned new space growth of about 5% in the US in

Group financial review (continued)

2008/09 is below that achieved in 2006/07 and 2007/08, a lower rate of like for like sales growth would be required to maintain the US operating margin than has recently been the case.

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

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

Movements in the US dollar to pound sterling exchange rate have an impact on the reported results of the Group as the UK division's results are translated into US dollars. A one cent movement in the exchange rate impacts profit before tax by some $0.4 million. The Board believes it is inappropriate to hedge this exposure as the UK division's sales and costs are denominated in pounds sterling.

52 weeks ended 2 February 2008

2007/08 was a 52 week year and the comparable period was the 53 weeks to 3 February 2007. To demonstrate better the underlying trends within the business, percentage changes of sales at constant exchange rates and like for like sales, use the 52 weeks to 3 February 2007 as the comparable period. Total Group sales rose to $3,665.3 million (2006/07: $3,559.2 million), up by 3.0% on a reported basis and 3.2% on a 52 week constant exchange rate basis (see page 37). Group like for like sales were down by 0.7% and net new store space contributed 3.9%.

Group operating margin decreased to 9.6% (2006/07: 11.7%), reflecting a decline in the US division and an increased operating margin in the UK division after adjusting for the impact of the 53rd week in 2006/07, (see table opposite). Group operating profit fell to $351.3 million (2006/07: $416.2 million), down by 15.6% on a reported basis and by 15.9% on a 52 week constant exchange rate basis (see page 37).

Net financing costs amounted to $17.8 million (2006/07: $15.4 million), the increase being primarily due to incremental borrowing as a result of the share buyback programme commenced in 2006/07 and which was completed in the first quarter of 2008/09.

Group profit before tax decreased to $333.5 million (2006/07: $400.8 million), down by 16.8% on a reported basis and by 17.4% on a 52 week constant exchange rate basis (see page 37). The 53rd week contributed some $3.2 million to profit before tax in 2006/07. Profit for the financial period fell by 19.1% to $215.2 million (2006/07: $266.0 million), a decrease of 19.7% on a 52 week constant exchange rate basis (see page 37). Basic earnings per share was 12.6 cents (2006/07: 15.4 cents), down by 18.2% on a reported basis and by 18.7% on a constant exchange rate basis (see page 37).

Sales

Components of 2007/08 sales growth

	US %	UK %	Group %
Like for like on a 52 week basis	(1.7)	2.0	(0.7)
Change in net new store space	5.8	(1.1)	3.9
Exchange translation	–	6.5	1.7
Total sales growth on a 52 week basis	4.1	7.4	4.9
Impact of 53rd week in 2006/07	(2.1)	(1.6)	(1.9)
Total sales growth as reported	2.0	5.8	3.0

US

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%. The contribution from new store space was 5.8% and the 53rd week in 2006/07 was adverse by 2.1%. Total sales as reported rose by 2.0% (see table above).

UK

Like for like sales growth was 2.0%, an encouraging performance in an increasingly challenging marketplace. As in the US, performance in the first nine months of 2007/08 was stronger at 4.7%, but became more difficult in the fourth quarter with like for like sales declining by 1.7%. The impact of changes in net new store space was a decrease of 1.1%, foreign exchange movements increased reported sales by 6.5% and the 53rd week in 2006/07 was adverse by 1.6% (see table above). Total sales as reported increased by 5.8%.

Operating profit

Operating margin movement

	US %	UK %	Group %
2006/07 margin	12.3	11.4	11.7
Impact of 53rd week	0.2	(0.2)	0.1
	12.5	11.2	11.8
Gross margin	(0.3)	(0.6)	(0.4)
Expenses	(1.9)	0.4	(1.4)
New store space	(0.6)	–	(0.4)
2007/08 margin	**9.7**	**11.0**	**9.6**

US

The operating margin in the US division was 9.7% (2006/07: 12.3%). This reflected deleverage of 190 basis points due to the like for like sales decline, the impact of additional immature space of 60 basis points, an adverse movement in gross margin percentage of 30 basis points and the impact in 2006/07 of the 53rd week of 20 basis points (see table above). Administrative expenses (see definition page 87) increased reflecting the resources required to support the growth of the division. The ratio of net bad debt to sales deteriorated to 3.4% (2006/07: 2.8%) but was largely offset by additional income on the receivables portfolio due to the lower monthly collection rate. Operating profit was $262.2 million (2006/07: $326.7 million), down by 19.6% on a 52 week basis (see page 37) and 19.7% as reported.

UK

The operating margin in the UK division was 11% (2006/07: 11.4%). The division's gross margin was down by 60 basis points, primarily caused by changes in mix due to the strong performance of the watch category, some impact from commodity costs and an increasing proportion of sales from Ernest Jones. A tight control of costs was maintained and resulted in a 40 basis point benefit to operating margin but the benefit to 2006/07 of the 53rd week had an adverse impact of 20 basis points (see table on page 36). Operating profit increased 1.6% to $105.1 million (2006/07: $103.4 million). The benefit of the 53rd week on operating profit was about $3.3 million and on a 52 week constant exchange rate basis operating profit was little changed. Administrative costs in the UK increased on a reported basis due to the movement in the US$/pound sterling exchange rate but were little changed as a percentage of sales.

Group costs

Group central costs amounted to $16.0 million (2006/07: $13.9 million) reflecting the impact of exchange translation movements and higher professional fees.

Taxation

The charge of $118.3 million (2006/07: $134.8 million) represents an effective tax rate of 35.5% (2006/07: 33.6%). The rate is lower than indicated in the third quarter results due to the change in the mix of profit between the US and UK businesses and a more favourable resolution of certain prior year tax positions. It is anticipated that, subject to the outcome of various uncertain tax positions, the Group's effective tax rate in 2008/09 will be at a similar level to the reported rate in 2007/08.

Return on capital employed

The Group's ROCE was 16.8% (2006/07: 22.8%). In the US the ROCE was 14.9% (2006/07: 21.5%) reflecting lower operating profits and the additional investment in a 10% increase in net new store space. US capital employed included in-house credit card debtors of $840.2 million at 2 February 2008 ($778.9 million at 3 February 2007). In the UK there was a decrease to 29.9% (2006/07: 32.7%).

Depreciation, amortisation and capital expenditure

Depreciation and amortisation charges were $114.1 million (2006/07: $98.4 million), representing $72.1 million (2006/07: $61.3 million) in the US and $42.0 million (2006/07: $37.1 million) in the UK. Capital expenditure in the US was $111.1 million (2006/07: $101.1 million) and in the UK was $29.3 million (2006/07: $23.3 million). Capital expenditure in the US is primarily due to the rate of new store space growth while that of the UK reflected the number of stores refurbished and the phased replacement of the EPOS System. Capital expenditure in 2008/09 is expected to be about $140 million as a result of an anticipated decrease in the rate of space growth in the US and a planned increase in refurbishments in the UK.

Impact of constant exchange rates and 53rd week

The Group has historically used constant exchange rates to compare period to period changes in certain financial data. This is referred to as "at constant exchange rates" throughout this Annual Report & Accounts. The Group considers this to be a useful measure for analysing and explaining changes and trends in the Group's results. The impact of the recalculation of sales, operating profit, profit before tax, profit for the financial period and earnings per share at constant exchange rates and the impact of the 53rd week in 2006/07, including a reconciliation to the Group's GAAP results, is analysed below.

	2007/08 $m	2006/07 $m	Growth at actual exchange rates %	Impact of 53rd week $m	2006/07 on 52 week basis at actual exchange rates (non-GAAP) $m	2007/08 52 week growth at actual exchange rates (non-GAAP) %	Impact of exchange rate movement $m	2006/07 on 52 week basis at constant exchange rates (non-GAAP) $m	2007/08 52 week growth at constant exchange rates (non-GAAP) %
Sales by origin and destination:									
UK	**959.6**	907.1	5.8	(13.2)	893.9	7.4	57.0	950.9	0.9
US	**2,705.7**	2,652.1	2.0	(52.2)	2,599.9	4.1	–	2,599.9	4.1
	3,665.3	3,559.2	3.0	(65.4)	3,493.8	4.9	57.0	3,550.8	3.2
Operating profit:									
UK – Trading	**105.1**	103.4	1.6	(3.3)	100.1	5.0	6.4	106.5	(1.3)
– Group function	**(16.0)**	(13.9)	n/a	–	(13.9)	n/a	(0.9)	(14.8)	n/a
	89.1	89.5	(0.4)	(3.3)	86.2	3.4	5.5	91.7	(2.8)
US	**262.2**	326.7	(19.7)	(0.5)	326.2	(19.6)	–	326.2	(19.6)
	351.3	416.2	(15.6)	(3.8)	412.4	(14.8)	5.5	417.9	(15.9)
Profit before tax	**333.5**	400.8	(16.8)	(3.2)	397.6	(16.1)	6.1	403.7	(17.4)
Profit for the financial period	**215.2**	266.0	(19.1)	(2.1)	263.9	(18.4)	4.3	268.2	(19.7)
Earnings per share	**12.6c**	15.4c	(18.2)	(0.1)c	15.3c	(17.5)	0.2c	15.5c	(18.7)

Group financial review (continued)

Dividends

In November 2007 an interim dividend of 0.96 cents per share was paid (2006/07: 0.4434p). The Board is recommending to shareholders a final dividend of 6.317 cents (2006/07: 6.317 cents) per share for 2007/08, which, subject to shareholder approval, is to be paid on 3 July 2008 to those shareholders on the register of members at close of business on 23 May 2008. This represents an increase in the total dividend for the year of 1.6% converting the interim dividend paid in 2006 at the US dollar pound sterling rate from Reuters at 4.00 p.m. on 3 November 2006. The US dollar to pound sterling rate used to convert the 6.317 cents dividend per share for payment to shareholders who elect to receive a pound sterling dividend, will be the rate as derived from Reuters at 4.00 p.m. on the record date of 23 May 2008.

Given the substantial increase in economic and financial sector uncertainties, the Board will continue to evaluate the dividend policy in the 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.

Under English law, dividends can only be paid out of profits available for distribution (generally defined as accumulated realised profits less accumulated realised losses, less unrealised losses) and not out of share capital or share premiums (generally equivalent in US terms to paid-in surplus). At 2 February 2008, after taking into account the subsequently recommended final dividend of 6.317 cents per share (2006/07: 6.317 cents per share), the holding company had distributable reserves of $283.2 million (3 February 2007: $199.0 million).

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

Liquidity and capital resources

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

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

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

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

In years when the rate of new store space expansion in the US is below the planned 8% – 10% range, the Group will have reduced levels of investment in fixed and working capital. The level of store refurbishment and relocation varies from year to year and fixed capital investment will reflect these changes. In 2007/08 the decline in profits meant that there was a cash outflow of $120.6 million (2006/07: $30.7 million) before exchange adjustments and the repurchase of shares amounting to $29.0 million (2006/07: $63.4 million) and proceeds from the issue of shares of $6.0 million (2006/07: $7.7 million).

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

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

In 2007/08 cash generated from operations amounted to $294.7 million (2006/07: $346.4 million) after funding a working capital increase of $171.0 million (2006/07: $173.5 million), principally as a result of the growth of space in the US division and slightly higher than planned inventory at the year end. It is anticipated that in 2008/09 there will be a further increase in the level of working capital due to planned US store openings however, this is expected to be significantly less than in 2007/08. Interest of $29.8 million (2006/07: $31.4 million) and tax of $128.5 million (2006/07: $130.1 million) were paid. Net cash flows from operating activities was $136.4 million (2006/07: $184.9 million).

Group capital expenditure was $140.4 million (2006/07: $124.4 million). The level of capital expenditure was some 1.2 times the depreciation and amortisation charge of $114.1 million (2007/08: $98.4 million). Equity dividends of $123.9 million (2006/07: $108.7 million) were paid, and $29.0 million (2006/07: $63.4 million) was utilised to repurchase shares. $6.0 million (2006/07: $7.7 million) was received from the proceeds of issuing shares. The increase in net debt before exchange adjustment was $143.6 million (2006/07: $86.4 million). In 2008/09, subject to the general economic uncertainty, the increase in net debt is expected to be between $40 million and $80 million before exchange adjustments and movements in equity, reflecting a similar level of capital expenditure, lower investment in working capital and an anticipated decrease in tax payments.

Net debt

Net debt at 2 February 2008 was $374.6 million (3 February 2007: $233.2 million). Group gearing at the year end was 20.7% (3 February 2007: 13.4%).

In October 2007 the Group entered into a 364 day $200m Series 2007 asset backed variable funding note conduit securitisation facility for general corporate purposes. Under this securitisation, interests in the US receivables portfolio are sold to Bryant Park, a conduit administered by HSBC Securities (USA) Inc. This facility has not been utilised.

On 30 March 2006 Signet entered into a US Private Placement Note Term Series Purchase Agreement ("Note Purchase Agreement") which was funded largely from US insurance sector institutional investors in the form of fixed rate investor certificate notes ("Notes"). These Notes represent 7, 10 or 12 year maturities, with Series (A) $100 million 5.95% due 2013; Series (B) $150 million 6.11% due 2016 and Series (C) $130 million 6.26% due 2018. The aggregate issuance was $380 million and the funding date was 23 May 2006. The proceeds from this debt issuance were used to refinance the maturing securitisation programme of $251.0 million which ended in November 2006 and for general corporate purposes. The Notes rank pari passu with the Group's other senior unsecured debt. The principal financial covenants on this Note Purchase Agreement are identical to the Group's $390 million multi-currency revolving credit facility which are as follows:

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

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

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

The continued availability of the Facility Agreement is conditional upon the Group achieving certain financial performance criteria (see above). It also has certain provisions which are customary for this type of agreement, including standard "negative pledge" and "pari passu" clauses. At 2 February 2008 and 9 April 2008 the amount outstanding under the Facility Agreement was $nil.

It is the policy of the Group to enter into interest rate protection agreements in respect of at least 75% of its forecast US dollar borrowings. At 2 February 2008 the interest rate of 72% of forecast US dollar borrowings for 2008/09 was capped effectively at 6.1%.

Pensions

The Group has one defined benefit plan (the "Group Scheme") for UK based staff, which was closed to new members in 2004. All other pension arrangements consist of defined contribution plans. The IAS 19 present value of obligations of the Group Scheme decreased by $4.2 million (2006/07: increase of $6.9 million) the largest movement being an actuarial gain of $15.1 million (2006/07: actuarial gain of $32.5 million). The market value of the Group Scheme's assets decreased by $13.5 million (2006/07: increased by $38.0 million). As a result there was a retirement benefit deficit on the balance sheet of $5.6 million (3 February 2007: $3.7 million asset) before a related deferred tax asset of $1.6 million (3 February 2007: $1.2 million liability). The triennial actuarial valuation was carried out as at 5 April 2006. There was a surplus and as a result no additional contributions were required as part of a recovery plan to eliminate a deficit.

The cash contribution to the Group Scheme in 2007/08 was $7.2 million (2006/07: $6.8 million), and the Group expects to contribute some $7.4 million in 2008/09.

Contractual obligations as at 2 February 2008

	Less than one year	Between one and three years	Between three and five years	More than five years	**Total $m**
Long term debt obligations	–	–	–	380.0	**380.0**
Operating lease obligations	299.0	541.2	460.4	1,227.8	**2,528.4**
Purchase obligations	56.7	–	–	–	**56.7**
Fixed interest and commitment fee payments	23.9	47.0	46.5	459.8	**577.2**
Creditors falling due after one year	–	–	–	38.1	**38.1**
Current tax	79.5	–	–	–	**79.5**
Total	459.1	588.2	506.9	2,105.7	**3,659.9**

(1) As at 2 February 2008 the Group had no significant outstanding floating rate indebtedness.
(2) The expected Group pension contribution to the Group Scheme has been excluded from the table as have obligations for subsequent years. The Group expects to contribute some $7.4 million in 2008/09.

Group financial review (continued)

Contingent property liabilities
Approximately 130 UK property leases had been assigned by the Group up to 2 February 2008 (and remained unexpired and occupied by assignees at that date) and approximately 26 additional properties were sub-let at that date. Should the assignees or sub-tenants fail to fulfil any obligations in respect of those leases or any other leases which have at any other time been assigned or sub-let, the Group or one of its UK subsidiaries may be liable for those defaults. The number of such claims arising to date has been small, and the liability, which is charged to the income statement as it arises, has not been material.

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

Prior year review 53 weeks ended 3 February 2007

The prior year review for the 53 weeks ended 3 February 2007 has been restated into US dollars, having been originally published in pounds sterling.

Total Group sales rose to $3,559.2 million (2005/06: $3,154.1million), up by 12.8% on a reported basis and 11.5% at constant exchange rates (see page 41). On a 52 week basis Group like for like sales were up by 5.4% and net new store space contributed 4.5%. The 53rd week contributed 1.6% to sales in 2006/07 (see table opposite).

Group operating margin decreased to 11.7% (2005/06: 11.9%), reflecting a decline in the operating margin of the US division and an increase in that of the UK division (see table opposite). The 53rd week contributed some $3.4 million to operating profit in 2006/07. Group operating profit increased to $416.2 million (2005/06: $374.7 million), up by 11.1% on a reported basis and 10.1% at constant exchange rates (see page 41), as total sales growth more than compensated for the decline in operating margin.

Net financing costs amounted to $15.4 million (2005/06: $14.0 million), the increase being primarily due to the transition from a securitised borrowing facility to the new private placement note facility and incremental borrowing as a result of the share buyback programme offset by the movement in the US dollar/pound sterling exchange rate.

Group profit before tax increased to $400.8 million (2005/06: $360.7 million), up by 11.1% on a reported basis and 10.1% at constant exchange rates (see page 41). The 53rd week contributed some $3.4 million to profit before tax in 2006/07. Profit for the financial period increased by 13.0% to $266.0 million (2005/06: $235.4 million), an increase of 11.9% at constant exchange rates (see page 41). Basic earnings per share was 15.4 cents (2005/06: 13.6 cents), up by 13.2% on a reported basis and 12.4% at constant exchange rates (see page 41).

Sales

Components of 2006/07 sales growth

	US %	UK %	Group %
Like for like on a 52 week basis	7.0	1.1	5.4
Change in net new store space	6.2	0.1	4.5
Exchange translation	–	4.6	1.3
Impact of 53rd week	1.7	1.5	1.6
Total sales growth	14.9	7.3	12.8

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

UK
The UK business saw sales stabilise in 2006/07 after a sharp deterioration in 2005/06. The strategy of increasing diamond participation continued to drive improvements in performance indicators such as average selling price, with the volume of transactions reduced. On a 52 week basis like for like sales increased by 1.1%, the impact of changes in net new store space was 0.1%, the impact of exchange rate movements was 4.6% and the 53rd week 1.5% (see table above). Total sales increased by 7.3%.

Operating profit

Operating margin movement

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

US
The operating margin in the US division was 12.3% (2005/06: 13.0%). Leverage of 70 basis points from like for like sales growth partly offset the impact of additional immature space of 50 basis points as well as the adverse movement in gross margin percentage of 70 basis points and the impact of the 53rd week of 20 basis points (see table above). Administrative expenses (see definition page 87) increased reflecting the resources required to support the growth of the division. The ratio of net bad debt to sales improved a little to 2.8% (2005/06: 3.0%). Operating profit was $326.7 million (2005/06: $300.7 million), up by 8.6%. The commencement of television advertising for Valentine's Day 2007 in the last week of 2006/07, with the related sales benefit occurring in 2007/08, meant that the 53rd week did not contribute to operating profit.

UK
The division's gross margin increased by 30 basis points, the benefit from advantageous hedging positions and selective price increases more than offsetting higher commodity costs. The actions taken to reduce costs in 2005/06 benefited the business throughout 2006/07

and resulted in a 40 basis point improvement in operating margin (see table on previous page). Administrative costs in the UK were little changed due to cost savings implemented at the start of the year. The operating margin at 11.4% was up on last year (2005/06: 10.5%). Operating profit rose by 17.0% to $103.4 million (2005/06: $88.4 million) on a reported basis and 12.0% at constant exchange rates. The impact of the 53rd week on operating profit was about $3.4 million.

Group costs

Group central costs amounted to $13.9 million (2005/06: $14.4 million, including a property provision of $1.3 million).

Taxation

The charge of $134.8 million (2005/06: $125.3 million) represents an effective tax rate of 33.6% (2005/06: 34.7%). The rate is lower than previously indicated due to the tax treatment of share options and the favourable resolution of certain prior year tax positions during the year. It is anticipated that, subject to the outcome of various uncertain tax positions, the Group's effective tax rate in 2007/08 may increase to a level of up to 37%, this being an approximation to the underlying effective tax rate for the Group.

Return on capital employed

The Group's ROCE was 22.8% (2005/06: 22.4%). In the US the ROCE was 21.5% (2005/06: 22.4%) reflecting the additional investment in an 11% increase in net new store space. In the UK there was an increase to 32.7% reflecting high leverage of capital employed (2005/06: 26.6%). US capital employed included in-house credit card debtors of $779.3 million at 3 February 2007 ($677.4 million at 28 January 2006).

Depreciation, amortisation and capital expenditure

Depreciation and amortisation charges were $98.4 million (2005/06: $83.2 million), $61.3 million (2005/06: $51.3 million) in the US and $37.1 million (2005/06: $31.9 million) in the UK. Capital expenditure in the US was $101.1 million (2005/06: $88.4 million) and in the UK was $23.3 million (2005/06: $48.2 million). The additional capital expenditure in the US is primarily due to the increase in the rate of new store space growth. The decrease in the UK reflected a lower level of expenditure in line with the fluctuations in the number of stores due to be refurbished. Capital expenditure in 2007/08 is expected to be in the range of $167.5 million to $187.2 million reflecting a further increase in the number of new stores opened in the US and a planned increase in relocations and new store openings in the UK.

Impact of constant exchange rates and 53rd week

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

	2006/07 $m	2005/06 $m	Growth at actual exchange rates %	Impact of exchange rate movement $m	2005/06 at constant exchange rates (non-GAAP) $m	Growth at constant exchange rates (non-GAAP) %	Impact of 53rd week $m	2006/07 52 weeks basis at constant exchange rates (non-GAAP) $m	52 week growth at constant exchange rates (non-GAAP) %
Sales by origin and destination:									
UK	907.1	845.3	7.3	37.6	882.9	2.7	(13.7)	893.4	1.2
US	2,652.1	2,308.8	14.9	–	2,308.8	14.9	(39.1)	2,613.0	13.2
	3,559.2	3,154.1	12.8	37.6	3,191.7	11.5	(52.8)	3,506.4	9.9
Operating profit:									
UK – Trading	103.4	88.4	17.0	3.9	92.3	12.0	(3.4)	100.0	8.3
– Group function	(13.9)	(14.4)	–	(0.6)	(15.0)	–	–	(13.9)	n/a
	89.5	74.0	20.9	3.3	77.3	15.8	(3.4)	86.1	11.4
US	326.7	300.7	8.6	–	300.7	8.6	–	326.7	8.6
	416.2	374.7	11.1	3.3	378.0	10.1	(3.4)	412.8	9.2
Profit before tax	400.8	360.7	11.1	3.5	364.2	10.1	(2.8)	398.0	9.3
Profit for the financial period	266.0	235.4	13.0	2.2	237.6	11.9	(1.7)	264.3	11.2
Earnings per share	15.4c	13.6c	13.2	0.1c	13.7c	12.4	(0.2c)	15.2c	10.9

Group financial review (continued)

Dividends

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

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

Under English law, dividends can only be paid out of profits available for distribution (generally defined as accumulated realised profits less accumulated realised losses, less unrealised losses) and not out of share capital or share premiums (generally equivalent in US terms to paid-in surplus). At 3 February 2007, after taking into account the subsequently recommended final dividend of 6.317 cents per share (2005/06: 2.8875p per share), the holding company had distributable reserves of $199.0 million (28 January 2006: $152.3 million).

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

Critical accounting policies

Critical accounting policies covering areas of greater complexity or those particularly subject to the exercise of judgement are listed below. There are no material off-balance sheet structures. The principal accounting policies are set out in note 1 on pages 86 to 90 in the Notes to the accounts.

These financial statements are presented in US dollars following a change in the Group's presentational currency from UK pounds to US dollars with effect from 5 February 2007. As the majority of the Group's assets and operations are in the US this change better reflects the underlying performance of the Group. On 5 February 2007 the Company redenominated its share capital into US dollars and will retain distributable reserves and declare dividends in US dolllars. The functional currency of the Company changed from UK pounds to US dollars. Financial information for prior periods has been restated from UK pounds to US dollars in accordance with IAS 21.

Implementation of IFRS

These accounts have been prepared on the basis of IFRS.

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

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

Revenue recognition

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

When promotional vouchers providing an incentive to enter into a future purchase are issued, the estimated fair value of these vouchers is deferred. The proportion of revenue deferred and the recognition of this revenue as these vouchers are redeemed or expire is based on prior years' experience.

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

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

Inventory valuation

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

Where necessary, provision is made for obsolete, slow-moving and damaged stock. This provision represents the difference between the cost of the stock and its estimated market value, based upon stock turn rates, market conditions and trends in consumer demand. For further detail on the provisions for inventory and the amount of reserves recorded each year, refer to note 13 on page 99.

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

Foreign currency translation

The results of subsidiary undertakings with functional currencies other than US dollars are translated into US dollars at the weighted average rates of exchange during the period and their balance sheets and attributable goodwill at the rates at the balance sheet date. Exchange differences arising from the translation of the net assets of these subsidiary undertakings are charged or credited to reserves. Other exchange differences arising from foreign currency transactions are included in profit before taxation.

Hedge accounting

Changes in the fair value of financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity through the consolidated statement of recognised income and expense. Any ineffective portion of the gain or loss is recognised

immediately in the income statement. For cash flow hedges that result in the recognition of a non-financial asset or liability, amounts previously deferred in equity are included in the measurement of the asset or liability. For cash flow hedges that result in the recognition of a financial asset or liability, amounts previously recognised in equity are recognised in the income statement in the same period in which the hedged item affects the Group's net profit or loss.

Taxation

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

Depreciation and impairment

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

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

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

Lease costs and incentives

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

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

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

Receivables

Trade and other receivables are stated net of a provision for uncollectible balances. This provision is based on the Group's past experience and the payment history of individual customers. The Group regularly reviews its individual receivable balances and when it assesses that a balance has become irrecoverable it is fully written off. The Group provides credit facilities to customers upon completing appropriate credit tests.

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

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

UK retirement benefits

The surplus or deficit on the Group Scheme that is credited or charged to shareholders' equity through the Consolidated statement of recognised income and expense is subject to a number of assumptions and uncertainties. A qualified actuary is engaged to calculate the expected liabilities of the Group Scheme based primarily on assumptions regarding salary and pension increases, inflation rates, discount rates, projected life expectancy and the long term rate of return expected on the Group Scheme's assets. A full actuarial valuation was completed as at 5 April 2006 and the Group Scheme valuation is updated at each year end based on actuarial assumptions as of the year end date. The assumptions set are based on the advice of the actuary and details of these assumptions are given in note 21 on page 105. The sensitivity of the Group Scheme assets, liabilities and funded position to the assumptions made is presented on page 105. The discount rate is based on the yield at the balance sheet date of AA rated corporate bonds of equivalent currency and term to the Group Scheme's liabilities. The value of the assets of the Group Scheme is measured as at the balance sheet date, this being particularly dependent on the value of equity investments held by the Group Scheme at that date. The overall impact on the Group balance sheet is significantly mitigated as the members of the Group Scheme are only in the UK and account for about 11% of UK employees. The Group Scheme ceased to admit new employees from April 2004.

Share-based payments

The Group recognises a charge to income in respect of the fair values of outstanding employee share options and the Group's estimate of the numbers of options that will eventually vest. The fair values are calculated at the grant date using the Black-Scholes option pricing model up to 29 January 2005 and for LTIP schemes thereafter and a binomial valuation model from 30 January 2005 and are charged to the income statement from the grant date over the relevant option vesting period. The key assumptions surrounding the valuation of employee share options include the risk free interest rate, expected life of options, expected volatility and dividend yield. The expected volatility is based on the five year average historical volatility. Full details of all assumptions are given in note 27 on page 115. The optional transitional arrangements, which allowed companies to apply IFRS 2 fully retrospectively to all options granted but not fully vested at the relevant reporting date, was used.