

## PART IX

### OPERATING AND FINANCIAL REVIEW

*The selected historical financial information discussed in this operating and financial review of the Group has been extracted from Part X, prepared in accordance with US GAAP. You should read the following discussion of the Group's financial condition and results of operations together with the rest of this document, including the financial information in Part X "Accountant's Reports and Financial Information" and should not rely solely on the summarised information contained in this Part IX.*

#### **1. Key Factors Affecting Results of Operations**

The Group's sales are seasonal with the first and second quarter both typically accounting for slightly more than 20 per cent of annual sales, the third quarter accounting for a little under 20 per cent and the fourth quarter accounting for about 40 per cent of sales, with December being by far the most important month of the year. Due to operating leverage the operating income of the Group is even more seasonal, with nearly all the UK division's, and a little over 50 per cent of the US division's, operating income occurring in the fourth quarter. Group costs occur broadly evenly during the year, while net interest 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 operating income is generated in the UK and the Group has reported its results in US dollars.

The gross merchandise margin percentage in retail jewellery is above the average for speciality retailers, reflecting the slow inventory turn. The trend in gross merchandise margin depends on the Group'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 merchandise 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 merchandise 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 merchandise margin percentage. In addition, the gross merchandise margin percentage of a Jared store 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 merchandise margin percentage and a change in the proportion of sales from Jared will have an impact on the gross merchandise 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 merchandise margin percentage is expected to show a small decline in most years.

The cost of goods sold used to arrive at gross margin 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.

To maintain the operating income 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.

The Group's target of 8 per cent to 10 per cent 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 4 per cent in the US in 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. In addition, the actions taken to control costs in 2008/09 further reduced the required level.

The impact on operating income of sales variances (either adverse or favourable) is less in the US division than the UK, as certain variable expenses such as sales-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 income 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 income before income taxes by some \$0.5 million. The Directors believe it is inappropriate to hedge this exposure as the UK division's sales and costs are denominated in pounds sterling.

The results of the Group's operations are affected by many factors. This section sets out certain key factors that the Directors believe have affected the Group's results of operations or could affect its results of operations in the future. For a discussion of certain factors that may adversely affect the Group's results of operations and financial condition, please also see Part II "Risk Factors".

## 2. Results of Operations

### 2.1 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 per cent on a reported basis and 3.2 per cent on a 52 week constant exchange rate basis (see table at Section 2.1.7, below). Group like for like sales were down by 0.7 per cent and net new store space contributed 3.9 per cent.

Group operating margin decreased to 9.8 per cent (2006/07: 11.4 per cent), 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 income fell to \$358.7 million (2006/07: \$404.8 million), down by 11.4 per cent on a reported basis and by 11.7 per cent on a 52 week constant exchange rate basis (see table at Section 2.1.7, below).

Net interest amounted to \$22.5 million (2006/07: \$17.5 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 2007/08.

Group income before income taxes decreased to \$336.2 million (2006/07: \$387.3 million), down by 13.2 per cent on a reported basis and by 13.8 per cent on a 52 week constant exchange rate basis. The 53rd week contributed some \$3.2 million to income before income taxes in 2006/07. Net income for the financial period fell by 13.0 per cent to \$219.8 million (2006/07: \$252.7 million), a decrease of 13.8 per cent on a 52 week constant exchange rate basis. Basic earnings per share was 12.9 cents (2006/07: 14.6 cents), down by 11.6 per cent on a reported basis and by 12.8 per cent on a constant exchange rate basis.

#### 2.1.1 Sales

##### Components of 2007/08 sales growth

	<u>US per cent</u>	<u>UK per cent</u>	<u>Group per cent</u>
Like for like sales 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 53 <sup>rd</sup> week in 2006/07 .....	(2.1)	(1.6)	(1.9)
Total sales growth as reported .....	<u>2.0</u>	<u>5.8</u>	<u>3.0</u>

The US division's like for like sales growth slowed in the first nine months of 2007/08 to 2.7 per cent, 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 per cent, resulting in a full year decline of 1.7 per cent. The contribution from new store space was 5.8 per cent and the 53rd week in 2006/07 was adverse by 2.1 per cent. Total sales as reported rose by 2.0 per cent (see table above).

The UK division's like for like sales growth was 2.0 per cent, which was 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 per cent, but became more difficult in the fourth quarter with like for like sales declining by 1.7 per cent. The impact of changes in net new store space was a decrease of 1.1 per cent, foreign exchange movements increased reported sales by 6.5 per cent and the 53rd week in 2006/07 was adverse by 1.6 per cent. Total sales as reported increased by 5.8 per cent (see table above).

### 2.1.2 *Operating income*

#### **Operating income margin movement**

	<u>US per cent</u>	<u>UK per cent</u>	<u>Group per cent</u>
2006/07 margin .....	12.0	11.0	11.4
Impact of 53 <sup>rd</sup> week .....	<u>0.2</u>	<u>(0.2)</u>	<u>0.1</u>
	12.2	10.8	11.5
Gross merchandise margin .....	(0.3)	(0.6)	(0.4)
Expenses .....	(1.5)	1.2	(0.9)
New store space .....	<u>(0.6)</u>	<u>–</u>	<u>(0.4)</u>
<b>2007/08 margin .....</b>	<b><u>9.8</u></b>	<b><u>11.4</u></b>	<b><u>9.8</u></b>

The operating margin in the US division was 9.8 per cent (2006/07: 12.0 per cent). This reflected deleverage of 150 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 merchandise 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 increased reflecting the resources required to support the growth of the division. The ratio of net bad debt to sales deteriorated to 3.4 per cent (2006/07: 2.8 per cent) but was largely offset by additional income on the receivables portfolio due to the lower monthly collection rate. Operating income was \$265.2 million (2006/07: \$318.9 million), down by 16.7 per cent on a 52 week basis and 16.8 per cent as reported.

The operating margin in the UK division was 11.4 per cent (2006/07: 11.0 per cent). The division's gross merchandise 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 120 basis point benefit to operating margin but the benefit to 2006/07 of the 53rd week had an adverse impact of 20 basis points. Operating profit increased 9.3 per cent to \$109.3 million (2006/07: \$100.0 million). The benefit of the 53rd week on operating income was about \$3.3 million and on a 52 week constant exchange rate basis operating income in 2006/07 was \$102.9 million.

### 2.1.3 *Group costs*

Group central costs amounted to \$15.8 million (2006/07: \$14.1 million) reflecting the impact of exchange translation movements and higher professional fees.

### 2.1.4 *Taxation*

The charge of \$116.4 million (2006/07: \$134.6 million) represents an effective tax rate of 34.6 per cent (2006/07: 34.8 per cent).

### 2.1.5 *Return on capital employed ("ROCE")*

The Group's ROCE is a non-GAAP measure calculated from the operating income divided by average capital employed excluding goodwill. It was 17.3 per cent (2006/07: 22.4 per cent). In the US the ROCE excluding goodwill was 15.1 per cent (2006/07: 21.2 per cent) reflecting lower operating income and the additional investment in a 10 per cent 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 33.7 per cent (2006/07: 34.0 per cent).

### 2.1.6 Depreciation, amortisation and capital expenditure

Depreciation and amortisation charges were \$113.9 million (2006/07: \$98.4 million), representing \$72.1 million (2006/07: \$61.3 million) in the US and \$41.8 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 was 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.

### 2.1.7 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, which is referred to as “at constant exchange rates” throughout this document. 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 income, income before income taxes, net income 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	2006/07	Growth at actual exchange rates	Impact of 53 <sup>rd</sup> week	2006/07 on 52 week basis at actual exchange rates (non-GAAP)	2007/08 52 week growth at actual exchange rates (non-GAAP)	Impact of exchange rate movement	2006/07 on 52 week basis at constant exchange rates (non-GAAP)	2007/08 52 week growth at constant exchange rates (non-GAAP)
	\$m	\$m	per cent	\$m	\$m	per cent	\$m	\$m	per cent
Sales by origin and destination:									
UK .....	<b>959.6</b>	907.1	5.8	(13.2)	893.9	7.4	57.0	950.9	0.9
US .....	<b>2,705.7</b>	2,652.1	2.0	(52.2)	2,599.9	4.1	—	2,599.9	4.1
	<b>3,665.3</b>	3,559.2	3.0	(65.4)	3,493.8	4.9	57.0	3,550.8	3.2
Operating income:									
UK—Trading ...	<b>109.3</b>	100.0	9.3	(3.3)	96.7	13.0	6.2	102.9	6.2
—Group function ...	<b>(15.8)</b>	(14.1)	n/a	—	(14.1)	n/a	(0.9)	(15.0)	n/a
	<b>93.5</b>	85.9	8.8	(3.3)	82.6	13.2	5.3	87.9	6.4
US .....	<b>265.2</b>	318.9	(16.8)	(0.5)	318.4	(16.7)	—	318.4	(16.7)
	<b>358.7</b>	404.8	(11.4)	(3.8)	401.0	(10.5)	5.3	406.3	(11.7)
Income before income taxes .....									
	<b>336.2</b>	387.3	(13.2)	(3.2)	384.1	(12.5)	6.1	390.2	(13.8)
Net income .....	<b>219.8</b>	252.7	(13.0)	(2.1)	250.6	(12.3)	4.3	254.9	(13.8)
Earnings per share .....	<b>12.9c</b>	14.6c	(11.6)	(0.1)c	14.5c	(11.0)	0.3c	14.8c	(12.8)

### 2.1.8 Dividends

In November 2007 an interim dividend of 0.96 cents per share was paid (2006/07: 0.4434p), and a final dividend of 6.317 cents (2006/07: 6.317 cents) per share for 2007/08 was paid on 3 July 2008. This represents an increase in the total dividend for the year of 1.6 per cent 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 elected to receive a pound sterling dividend, was the rate as derived from Reuters at 4.00 p.m. on the record date of 23 May 2008.

Further details of the dividend policy of the Company going forward are set out at Section 6 of this Part IX.

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), Signet had distributable reserves of \$283.2 million (3 February 2007: \$199.0 million).

## 2.2 *Prior year review 53 weeks ended 3 February 2007*

Total Group sales rose to \$3,559.2 million (2005/06: \$3,154.1 million), up by 12.8 per cent on a reported basis and 11.5 per cent at constant exchange rates. On a 52 week basis Group like for like sales were up by 5.4 per cent and net new store space contributed 4.5 per cent. The 53<sup>rd</sup> week contributed 1.6 per cent to sales in 2006/07 (see table opposite). Group operating margin decreased to 11.4 per cent (2005/06: 11.7 per cent), reflecting a decline in the operating margin of the US division and an increase in that of the UK division (see table opposite). The 53<sup>rd</sup> week contributed some \$3.4 million to operating income in 2006/07. Group operating income increased to \$404.8 million (2005/06: \$370.5 million), up by 9.3 per cent on a reported basis and 8.3 per cent at constant exchange rates, as total sales growth more than compensated for the decline in operating margin. Net interest amounted to \$17.5 million (2005/06: \$16.2 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 income before income taxes increased to \$387.3 million (2005/06: \$354.3 million), up by 9.3 per cent on a reported basis and 8.2 per cent at constant exchange rates. The 53<sup>rd</sup> week contributed some \$2.8 million to income before income taxes in 2006/07. Net income increased by 6.2 per cent to \$252.7 million (2005/06: \$238.0 million), an increase of 5.2 per cent at constant exchange rates. Basic earnings per share was 14.6 cents (2005/06: 13.7 cents), up by 6.6 per cent on a reported basis and 5.8 per cent at constant exchange rates.

### 2.2.1 *Sales*

#### **Components of 2006/07 sales growth**

	<u>US per cent</u>	<u>UK per cent</u>	<u>Group per cent</u>
Like for like sales 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 53 <sup>rd</sup> week .....	<u>1.7</u>	<u>1.5</u>	<u>1.6</u>
Total sales growth .....	<u>14.9</u>	<u>7.3</u>	<u>12.8</u>

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

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 per cent, the impact of changes in net new store space was 0.1 per cent, the impact of exchange rate movements was 4.6 per cent and the 53<sup>rd</sup> week 1.5 per cent (see table above). Total sales increased by 7.3 per cent.

### 2.2.2 *Operating income*

#### **Operating income margin movement**

	<u>US per cent</u>	<u>UK per cent</u>	<u>Group per cent</u>
2005/06 margin .....	12.8	10.5	11.7
Gross merchandise margin .....	(0.7)	0.3	(0.5)
Expenses .....	0.8	0.2	0.8
Initial adoption of SFAS 123(R) .....	(0.2)	(0.2)	(0.2)
New store space .....	(0.5)	–	(0.3)
Impact of 53 <sup>rd</sup> week .....	<u>(0.2)</u>	<u>0.2</u>	<u>(0.1)</u>
2006/07 margin .....	<u>12.0</u>	<u>11.0</u>	<u>11.4</u>

The operating margin in the US division was 12.0 per cent (2005/06: 12.8 per cent). 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 53<sup>rd</sup> week of 20 basis points (see table above). Selling, general and administrative expenses 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 per cent (2005/06: 3.0 per cent). Operating income was \$318.9 million (2005/06: \$295.9 million), up by 7.8 per cent. 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 income.

The UK division's gross merchandise 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 20 basis point improvement in operating margin prior to the 20 basis points adverse impact arising from the implementation of SFAS 123(R). The operating margin at 11.0 per cent was up on last year (2005/06: 10.5 per cent). Operating income rose by 12.7 per cent to \$100.0 million (2005/06: \$88.7 million) on a reported basis and 8.0 per cent at constant exchange rates. The impact of the 53rd week on operating income was about \$3.4 million.

### 2.2.3 *Group Costs*

Group central costs amounted to \$14.1 million (2005/06: \$14.1 million, including a property provision of \$1.3 million).

### 2.2.4 *Income taxes*

The charge of \$134.6 million (2005/06: \$116.3 million) represents an effective income tax rate of 34.8 per cent (2005/06: 32.8 per cent).

### 2.2.5 *Return On Capital Employed*

The Group's ROCE is a non-GAAP measure calculated from the operating income divided by average capital employed excluding goodwill. It was 22.4 per cent (2005/06: 22.3 per cent). In the US the ROCE excluding goodwill was 21.2 per cent (2005/06: 22.1 per cent) reflecting the additional investment in an 11 per cent increase in net new store space. In the UK there was an increase to 34.0 per cent reflecting high leverage of capital employed (2005/06: 26.0 per cent). US capital employed included in-house credit card receivables of \$779.3 million at 3 February 2007 (\$677.4 million at 28 January 2006).

### 2.2.6 *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 was 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.

### 2.2.7 *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, which is referred to as "at constant exchange rates" throughout this document. 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 income, income before income taxes, net income 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	2005/06	Growth at actual exchange rates	Impact of exchange rate movement	2005/06 at constant exchange rates (non-GAAP)	Growth at constant exchange rates (non-GAAP)	Impact of 53 <sup>rd</sup> week	2006/07 52 weeks basis at constant exchange rates (non-GAAP)	52 week growth at constant exchange rates (non-GAAP)
	\$m	\$m	per cent	\$m	\$m	per cent	\$m	\$m	per cent
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
	<u>3,559.2</u>	<u>3,154.1</u>	<u>12.8</u>	<u>37.6</u>	<u>3,191.7</u>	<u>11.5</u>	<u>(52.8)</u>	<u>3,506.4</u>	<u>9.9</u>
Operating income:									
UK—Trading	100.0	88.7	12.7	3.9	92.6	8.0	(3.4)	96.6	4.3
—Group function	(14.1)	(14.1)	—	(0.6)	(14.7)	—	—	(14.1)	n/a
	<u>85.9</u>	<u>74.6</u>	<u>15.1</u>	<u>3.3</u>	<u>77.9</u>	<u>10.3</u>	<u>(3.4)</u>	<u>82.5</u>	<u>5.9</u>
US .....	318.9	295.9	7.8	—	295.9	7.8	—	318.9	7.8
	<u>404.8</u>	<u>370.5</u>	<u>9.3</u>	<u>3.3</u>	<u>373.8</u>	<u>8.3</u>	<u>(3.4)</u>	<u>401.4</u>	<u>7.4</u>
Income before income taxes	387.3	354.3	9.3	3.5	357.8	8.2	(2.8)	384.5	7.5
Net income ..	252.7	238.0	6.2	2.2	240.2	5.2	(1.7)	251.0	4.5
Earnings per share .....	14.6c	13.7c	6.6	0.1c	13.8c	5.8	(0.2)c	14.4c	4.3

### 2.2.8 Dividends

In November 2006 an interim dividend of 0.4434p per share was paid (2005/06: 0.4125p) and a final dividend of 6.317 cents (2005/06: 2.8875p) per share was paid on 6 July 2007. Based on the exchange rate at 17 April 2007 this represented an increase in the total dividend for the year of 9.1 per cent.

## 3. Liquidity and Capital Resources

### 3.1 Cash flow

It is the objective of the Group to maintain a strong balance sheet, after implementing its 8 per cent to 10 per cent 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 per cent to 10 per cent 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 net income 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.

In 2007/08 net cash flows generated from operating activities amounted to \$142.7 million (2006/07: \$201.8 million) after funding a working capital increase of \$171.9 million (2006/07: \$172.6 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.

### 3.2 *Capital expenditure*

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 \$113.9 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.

### 3.3 *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 21.2 per cent (3 February 2007: 13.9 per cent).

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 per cent due 2013; Series (B) \$150 million 6.11 per cent due 2016 and Series (C) \$130 million 6.26 per cent 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 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.

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 26 June 2008 Signet entered into a \$520 million unsecured multi-currency five year revolving credit facility agreement (the "**Facility Agreement**"). The Facility Agreement replaced a similar \$390 million facility that had been entered into on 28 September 2004. 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 1.75 per cent 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 1.20 per cent 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 identical to those under the Note Purchase Agreement (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 previous facility agreement was \$nil. At 2 August 2008 the amount outstanding under the Facility Agreement was \$79.0 million.

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

The Group’s level of borrowings fluctuates during the year reflecting the cash flow performance of the Group. The cash flow performance of the Group depends on a number of factors described above and the Facility Agreement provides committed borrowing facilities for these cash flow demands.

### 3.4 Working capital

The Company is of the opinion that, taking into account the bank and other facilities available to the New Signet Group, the working capital available to the New Signet Group is sufficient for its present requirements, that is for at least the next twelve months from the date of publication of this document.

### 3.5 Capitalisation and indebtedness statement

#### 3.5.1 Capitalisation and indebtedness

The following table shows the capitalisation and indebtedness of the Group as at 2 August 2008:

	<u>\$ million</u>
<b>Total current debt</b>	
Guaranteed .....	–
Unguaranteed/unsecured .....	<u>(120.2)</u>
	(120.2)
<b>Total non-current debt (excluding current portion of long term debt)</b>	
Secured bank loans, loan notes and lease finance .....	–
Unsecured subordinated loan notes .....	<u>(380.0)</u>
<b>Total debt</b> .....	<b>(500.2)</b>
<b>Shareholders’ equity</b>	
Share capital .....	15.4
Share premium .....	163.5
Other reserves .....	235.2
Treasury stock .....	(10.8)
Retained earnings .....	1,856.4
Accumulated other comprehensive income .....	<u>2.1</u>
<b>Total shareholders’ equity</b> .....	<b>2,261.8</b>
<b>Total</b> .....	<b>1,761.6</b>

### 3.5.2 *Net financial indebtedness*

The following table shows the net financial indebtedness of the Group as at 2 August 2008:

	<u>\$ million</u>
<b>Cash</b> .....	<b>66.9</b>
Current bank debt .....	(120.2)
Current portion of non current secured loan notes and lease finance .....	—
<b>Current financial debt</b> .....	<b>(120.2)</b>
<b>Current net financial indebtedness</b> .....	<b>(53.3)</b>
Non current bank loans .....	—
Secured loan notes .....	—
Lease finance .....	—
Unsecured subordinated loan notes .....	(380.0)
<b>Non current financial indebtedness</b> .....	<b>(380.0)</b>
<b>Gross debt</b> .....	<b>(500.2)</b>
<b>Net financial indebtedness</b> .....	<b>(433.3)</b>

## 4. **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 Part X of this document.

### 4.1 ***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.

When promotional vouchers providing an incentive to enter into a future purchase are issued, the estimated fair value of these vouchers is treated as deferred revenue. The fair value of these vouchers is calculated based on prior years' experience.

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

### 4.2 ***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 inventory. This provision represents the difference between the cost of the inventory and its estimated market value, based upon inventory turn rates, market conditions and trends in consumer demand.

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

### 4.3 ***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 included in other comprehensive income. Other exchange differences arising from foreign currency transactions are included in net operating income.

#### **4.4 *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 statement of comprehensive income. Any ineffective portion of the gain or loss is recognised immediately in the income statement.

#### **4.5 *Taxation***

Accruals for tax contingencies require management to make judgements and estimates in relation to tax audit issues and exposures. Amounts reserved 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 more likely than not of being sustained. Once recognised, management reviews each material tax benefit taking account of potential settlement through negotiation and/or litigation. Any established reserves are included in payables. Any recorded exposure to interest and penalties on tax liabilities is included in the tax charge.

#### **4.6 *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 per cent and 33 1/3 per cent. 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, impairments are made on assets that have a recoverable amount less than net book value. Additionally, potentially impaired assets are identified by reviewing the cash flows of individual stores where trading since the initial opening of the store has reached a mature stage. Where such stores deliver low or negative cash flow, the related store assets are considered for impairment by reference to estimated future cash flows.

#### **4.7 *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 percentage rent (sales) leases are excluded from minimum rent and are included in the determination of rent expense when it is probable that the expense has been incurred and the amount can be reasonably estimated. Premiums paid to acquire short leasehold properties and incentives received relating to leased properties are amortised over the lease term.

#### **4.8 *Receivables***

Accounts receivable are stated net of an allowance for uncollectible balances. This allowance 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.

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

#### **4.9 *UK retirement benefits***

The expected liabilities of the Group Scheme are calculated 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. 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 consolidated balance sheet is significantly mitigated as the members of the Group Scheme are only in the UK and account for about 11 per cent of UK employees. The Group Scheme ceased to admit new employees from April 2004. In addition, if actuarial gains and losses exceed 10 per cent of the greater of plan assets or plan liabilities, the Group amortises those gains or losses over the average remaining service period of the employees.

#### 4.10 *Share-based Compensation*

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 Group estimated the fair value of all share-based awards using a Black-Scholes valuation model up to 29 January 2005. Subsequent to 29 January 2005, the Group continued to use a Black-Scholes valuation model for the Long-Term Incentive Plans ("LTIP") options; all other share-based awards, however, were valued using a binomial valuation model. 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. For certain share plans that include a condition whereby vesting is contingent on growth exceeding the scheme target adjusted by movements in the relevant UK or US Retail Price Index ("RPI") then the fair values are re-measured at the end of each reporting period until the criteria have been satisfied. For the share plans that do not have such a condition, the fair value is set at the grant date and used for the life of the option.

### 5. **Current Trading, Trends and Prospects**

In the 26 weeks ended 2 August 2008 Group income before income taxes, excluding non-recurring costs of \$10.5 million related to the move of the primary listing to the NYSE, fell by 28.6% to \$81.2 million (H1 2007/08: \$113.7 million). Like for like sales were down by 3.4% and total sales by 0.6% to \$1,591.4 million (H1 2007/08: \$1,601.8 million). The average US dollar exchange rate for the period was £1/\$1.98 (H1 2007/08: £1/\$1.99). The components of the change in sales are set out below:

<u>Change in sales</u>	<u>US</u>	<u>UK</u>	<u>Group</u>
	<u>%</u>	<u>%</u>	<u>%</u>
Like for like sales .....	(5.2)	2.3	(3.4)
Change in new store space .....	4.4	(1.9)	2.9
Exchange translation .....	–	(0.5)	(0.1)
<b>Total sales growth as reported</b>	<b>(0.8)</b>	<b>(0.1)</b>	<b>(0.6)</b>

Operating income excluding relisting costs fell by 24.1% to \$93.9 million (H1 2007/08: \$123.7 million) and operating margin was 5.9% (H1: 2007/08: 7.7%). On a reported basis the operating income was \$83.4 million.

The tax rate was 35.8% (H1 2007/08: 34.7%) and net income for the financial period was \$45.4 million. Diluted earnings per share were 2.7c (H1 2007/08: 4.4c). The Signet Board has approved an unchanged interim dividend of 0.96c.

The Group's strong balance sheet and superior operating metrics on both sides of the Atlantic enables the business to continue to implement its proven strategy. Appropriate adjustments in execution are being made to reflect the challenging economic conditions with tight control of costs, inventory, gross merchandise margin and investment in new space. As a result the business will be well positioned when the economy improves. However, in the short term, the consumer environment in both the US and the UK remains very challenging. As always, the results for the year will be significantly influenced by the Group's performance during the important Christmas period.

As at the date of this document, there have been no material changes in the capitalisation and indebtedness of the Company or the Group since 2 August 2008.

## **6. Dividends and Dividend Policy**

Following implementation of the Proposal, the Company intends to adopt a dividend policy that will continue to take into account the needs of the business including its store development programme, the significant competitive advantages of a strong balance sheet, as well as the wider economic environment. The Board will also take account of the payout ratios of US listed speciality retailers, which are typically lower than in the UK. The Board may also consider the repurchase of shares from time to time.

Signet declared an interim dividend of 0.96 cents per share when it announced its 6 months results to 31 July 2008 on 3 September 2008. It is intended that this interim dividend distribution by Signet will be passed on to shareholders by the Company in November 2008. A final dividend will be considered by the Company at the time of the full year results for 2008/09 in March 2009.

In subsequent years the Board intends to declare quarterly dividends.