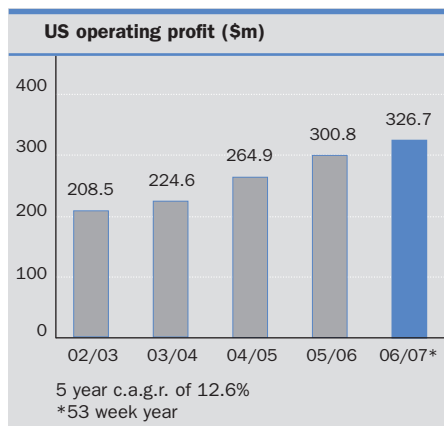
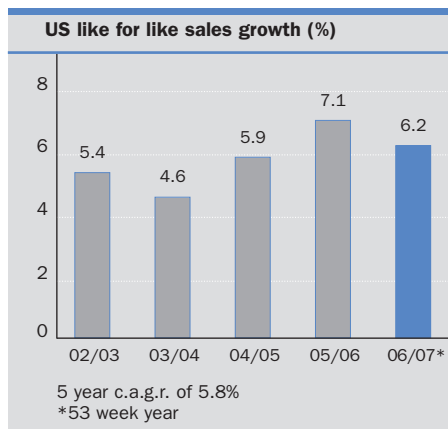


## US operating review



### Overview

Signet's US division is the largest speciality retail jeweller in the US with an approximate 8.8% (2005: 8.2%) share of the speciality jewellery market. It also became the largest speciality retail jeweller in North America during 2006/07. Total sales in 2006/07 were \$2,652 million (2005/06: \$2,309 million), being 75% of Group sales (2005/06: 73%).

The division targets the middle market through Kay Jewelers ("Kay"), which trades nationwide in malls and, increasingly, in outdoor shopping centres. Kay is the largest speciality retail jewellery brand in the US by sales and accounted for 42% (2005/06: 41%) of Group sales. The division also targets the middle market sector through a number of well established and recognised regional brands trading in malls. The regional stores amounted to 14% (2005/06: 15%) of Group sales.

The division's off-mall destination superstores target the upper middle market and trade as Jared The Galleria Of Jewelry ("Jared"). The 135 stores are equivalent in space terms to some 550 of the Group's mall stores. Jared, which accounts for 19% (2005/06: 17%) of Group sales, became the fourth largest US speciality retail jeweller by sales in 2006/07. It is by far the largest chain of middle market off-mall destination jewellery stores and the only one with national coverage. As a destination store Jared offers a wider selection of merchandise than mall stores at highly competitive prices.

Over the longer term, the division's aim is to gain further profitable market share through like for like sales growth and by focusing on proven competitive advantages. It aims also to increase US new store space by between 8% – 10% per annum, with Jared accounting for the majority of the planned space growth.

### Competitive advantages

Management attributes the division's success to a range of competitive advantages in store operations, human resources, real estate, merchandising, marketing and credit operations. These advantages are reflected in above industry-average sales per store and operating profit margin. The principal competitive advantages are summarised below, and are explained in greater detail over the following pages.

#### • Store operations and human resources

Experience demonstrates that a sales associate's ability to communicate and explain the value and quality of merchandise plays a significant part in a retail jewellery purchase. Therefore, the US division has developed specialised training for its retail associates, and its size provides leverage of training resources and systems. The division now has at least one certified diamondologist in each of its stores and all store managers are required to be so qualified.

#### • Real estate

Strict criteria are followed when evaluating real estate investment or lease renewal, and management believes that the quality of the store portfolio is superior to that of its competitors. The trading record and the strength of the Group balance sheet make Signet an attractive tenant.

#### • Merchandising

Management believes that Signet has a significant supply chain advantage compared to its competitors as it purchases merchandise at every stage of the supply chain. Significant experience within the merchandising staff, greater capacity, better systems and Signet's financial strength facilitate providing superior value, quality and consistency to the consumer. At the same time an above average gross margin percentage compared with the sector is achieved. In 2005/06 a multi-year trial, involving the purchase and contract polishing of rough diamonds commenced. In 2006/07 it was expanded. This trial is still at an early stage and the US division continues to purchase about 50% of the diamonds it sells as loose polished diamonds, which are supplied to contract manufacturers who then produce finished jewellery merchandise. In 2007/08 it is planned that the capability to purchase rough diamonds will be taken to the next stage of development.

The division's sophisticated merchandising systems test, track, forecast and respond to consumer preferences and assist in providing competitive advantage by ensuring high in-stock positions of key merchandising assortments. While offering a core merchandise selection within each brand, the division merchandises each store on an individual basis. The merchandising systems secure an increased turn of popular items, while minimizing inventory write-downs.

- **Marketing**

Management believes that television advertising is the most effective form of marketing. Kay is one of a very limited number of US speciality retail jewellery brands with a presence large enough to justify national television advertising. This form of advertising is advantageous as growth in the number of advertising impressions benefits all the stores in the chain rather than just those in a particular market; it also greatly assists entering new local markets. Ancillary benefits such as guarantees relating to audience levels, improved access to the best advertising slots and programme sponsorship opportunities can be gained.

Jared benefited from the roll-out of local television advertising, both network and cable, to all its markets between 2001/02 and 2005/06. For the 2006 Christmas season Jared had sufficient scale to use national cable television advertising together with local network television advertising. Jared is expected to have sufficient scale to use national network advertising for the 2007 Christmas season.

A trial of local television advertising for JB Robinson commenced in 2005/06 and was expanded in 2006/07.

- **Credit operations**

The ability to offer consumer credit provided by the division's own in-house department rather than a third party provider is believed by management to be a competitive advantage in enabling sales. About 50% of the division's sales utilise this facility.

## Initiatives and developments in 2006/07

Actions taken during 2006/07 to strengthen the Group's competitive position included:

### Store operations and human resources

- first phase of enhanced training system introduced;
- inclusion of customer satisfaction index in monitoring of store by store performance; and
- improved specialised jewellery repair training.

### Real estate

- increased number of Jared openings by 39% to 25;
- accelerated expansion of Kay off-mall store format;
- testing of Kay stores in outlet centres; and
- introduction of a Kay superstore format in superior regional malls.

### Merchandising

- rough diamond sourcing trial expanded;
- further development of the "right hand ring" category;
- continued expansion of Leo Diamond assortments;
- "Journey" diamond jewellery introduced in conjunction with a marketing initiative from the Diamond Trading Company;
- "Circle" jewellery range expanded
- a prestigious designer line, "Le Vian", made available in all Kay locations;
- luxury timepiece selection increased within Jared stores; and
- the "Peerless Diamond" launched in all Jared locations.

### Marketing

- an increase in national television advertising for Kay;
- national cable television advertising for Jared used for the first time in the fourth quarter of 2006/07;
- continued development of local television advertisements for JB Robinson; and
- the launch of an e-commerce capability for kay.com.

## Initiatives and developments for 2007/08

Initiatives and developments planned for 2007/08 include:

### Store operations and human resources

- complete roll-out of enhanced training procedures;
- continued focus on overall customer experience;
- system and training enhancements to improve the repair service provided to customers;
- improvements to recruiting processes;
- roll-out of broadband communications infrastructure, and upgrade of internal store communications systems.

### Real estate

- space increase planned at top end of 8%-10% target range;
- further acceleration in the number of Kay off-mall openings (up to 40 locations planned);
- continued testing of Kay in outlet centres;
- expansion in the number of Kay superstores; and
- maintain the planned level of Jared openings in the range of 20-25 stores per annum.

### Merchandising

- further development of rough diamond sourcing capability;
- expansion of the direct importing of merchandise;
- evolution of "Journey" assortments;
- continued expansion of Leo Diamond range; and
- development of the Peerless Diamond range in Jared.

### Marketing

- further growth in Kay television advertising;
- Jared is expected to move to national network television advertising for Christmas 2007;
- continued development of JB Robinson television commercials; and
- enhancement of the Kay website.

## Marketplace

Total US jewellery sales, including watches and fashion jewellery, are estimated by the US Department of Commerce to have been \$63.1 billion in calendar 2006 (2005: \$58.9 billion). The US jewellery market has grown at a compound annual growth rate of 5.7% over the last 25 years and in calendar 2006 grew by 7.1%. Management believes that the jewellery category competes with other sectors, such as electronics, clothing and furniture, as well as travel and restaurants for consumers' discretionary spending.

## US operating review (continued)



### Long term outlook

Jewellery sector sales have, over the longer term, grown faster than retail sales (source: US Department of Commerce and US Census Bureau) and the rate of growth accelerates and slows broadly in line with major non-food retail categories (see graph above). Management believes that a major contributor to the relationship with other non-food retail categories is that the majority of jewellery purchases are made in the middle mass market for bridal related or annual gift giving events. Jewellery sales outperformed other comparable sectors in the more buoyant late 1990's, underperformed in 2001 and have performed in line with the selected other non-food retail categories over the last five years. Over the last ten years Signet's total US dollar sales rose (including the acquisition of Marks & Morgan) at a compound annual growth rate of 11.6% compared to 4.8% for the jewellery sector as a whole.

The US retail jewellery industry is highly fragmented. The broader total US retail jewellery market includes formats such as department stores, discount outlets, television home shopping, internet retailers and general merchandise, apparel and accessory stores. The largest jewellery retailer, with an estimated 4.6% market share, is Wal-Mart Stores, Inc. (Source: National Jeweler) whose merchandise mix is believed to be markedly different to that of Signet's US division. Signet is the second largest and has steadily grown its market share to 4.2% in calendar 2006, compared to 2.2% in calendar 1996 and 3.3% in calendar 2001.

Management believes that the long term outlook for jewellery sales is encouraging given the expected growth in disposable income and the increasing number of women in the work force. However, jewellery sales are still subject to fluctuations in the general level of retail sales.

### Diamond jewellery sales

Diamond jewellery accounts for some 55% of total jewellery sales in the US market (Source: Diamond Information Centre). About 50% of worldwide diamond jewellery sales are made in the US according to the International Diamond Exchange. During the last ten years the industry growth in diamond jewellery sales has been 6.4% per annum compared to 4.5% for the total jewellery market. Diamond jewellery accounted for 72% of the US division's sales in 2006/07, compared to 60% in 1996/97 and 67% in 2001/02.

### Speciality jewellery sector

Speciality retailers accounted for 47.7% of the total jewellery market in calendar 2006 compared to 49.9% in calendar 1996 and 48.3% in 2001. The speciality jewellery sector grew by 6.7% in calendar 2006. The US division became the largest speciality jewellery retailer in the US in calendar 2005.

The US division has an 8.8% market share of the speciality sector and its largest direct competitor is Zale Corporation, which has a speciality market share of 7.4%. Competition is also encountered from a limited number of large regional retail jewellery chains, (only six other speciality jewellery retailers have more than \$300 million sales, according to National Jeweler), and independent retail jewellery stores (including smaller regional chains with sales of less than \$300 million) which accounted for in excess of 70% of the speciality market. Over the last ten years the larger chains have gained market share at the expense of the smaller operators (see table below).

### Share of speciality jewellery market

	1999	2001	2005	2006
Signet US	5.2%	6.8%	8.2%	8.8%
Zale Corp. US <sup>(2)</sup>	6.5%	8.4%	7.8%	7.4%
Chains ranked 3-7 <sup>(3)</sup>	9.5%	10.5%	10.1%	n.a. <sup>(4)</sup>
Other speciality jewellers	78.8%	74.2%	73.9%	n.a. <sup>(4)</sup>

(1) market size based on US Census Bureau data  
 (2) based on corporate announcements  
 (3) based on estimates produced by National Jeweler  
 (4) not yet available

In calendar 2006, the Jewelers Board of Trade estimated that there were some 23,778 speciality jewellery firms in the US, compared to 28,302 in 1996 and 25,753 in 2001, which is equivalent to a compound annual decrease of 1.7% since 1996. In 2006 the number of speciality firms declined by some 765, a fall of 3.1%, the greatest decline in more than ten years. The number of stores operated by the seven largest speciality jewellery retailers increased by about 1,100 over the ten years and reflects the continuing consolidation taking place in the sector. Signet's US division accounted for about 40% of the increase in store numbers of the seven largest speciality jewellery retailers since 1996.

The process of consolidation provides a significant growth opportunity for those businesses with competitive advantages in the sector, and it is believed that Signet is well positioned to gain further market share.

### Competitive strengths

The US division competes on the quality of its personal customer service; merchandise selection, availability and quality; and the value of its total offering. Brand recognition, trust and store locations are also competitive factors, as is the ability to offer private label credit card programmes to customers. The US division does not hold any material patents, licenses, franchises or concessions but has a range of trading agreements with suppliers, the most important being in regards of the Leo Diamond and luxury watches. The established trademarks and trade names of the division are essential to maintaining its competitive position in the retail jewellery industry.

## Store operations and human resources

A retail jewellery sale normally requires face-to-face interaction between the customer and the sales associate, during which the items being considered for purchase are removed from the display cases and presented one at a time with their respective qualities explained to the customer. Consumer surveys indicate that a key factor in the retail purchase of jewellery is the customer's confidence in the sales associate.

### Customer satisfaction

A customer satisfaction index covering 12 criteria was introduced during 2005/06 in certain trial stores and was expanded to all stores during 2006/07. Each store is benchmarked against others in its district, region and across the division based on customer feedback. The scores are reported on a monthly basis, highlighting areas of good performance and those for improvement.

### Training

Providing knowledgeable and responsive customer service is a priority, and is regarded by management as a key point of differentiation. It is believed that highly trained store sales staff, with the necessary product knowledge to communicate the quality, attributes and competitive value of the merchandise, are critical to the success of the business. The development of the customer satisfaction index has improved the

division's ability to design and implement its training programmes by identifying areas of strength and opportunity.

The US division's substantial training and incentive programmes, for all levels of store staff, are designed to play an important role in recruiting, educating and retaining qualified store staff. The preferred practice is to promote managers at all levels from within the business in order to maintain continuity and familiarity with the division's procedures.

Retail sales personnel are encouraged to become certified diamondologists by graduating from a comprehensive correspondence course provided by the Diamond Council of America. Over 50% of the division's full time sales staff who have completed their probationary period are certified diamondologists or are training to become certified. All store managers are required to be thus qualified. The number of certified diamondologists employed by the US division increased by 9% in 2006/07. Employees often continue their professional development through completion of further courses on gemstones.

### Goals and incentives

All store employees are set daily performance standards and commit to goals. Sales contests and incentive programmes also

The following table sets out information concerning the US stores operated by Signet during the period indicated:

	2006/07 <sup>(1)</sup>	2005/06	2004/05
Number of stores:			
Total opened during the year <sup>(2)</sup>	<b>104</b>	81	68
Kay	<b>58</b>	43	34
Regional chains	<b>21</b>	20	20
Jared	<b>25</b>	18	14
Total closed during the year	<b>(17)</b>	(16)	(15)
Kay	<b>(7)</b>	(4)	(9)
Regional chains	<b>(10)</b>	(11)	(6)
Jared	<b>-</b>	(1)	-
Total open at the end of the year	<b>1,308</b>	1,221	1,156
Kay	<b>832</b>	781	742
Regional chains	<b>341</b>	330	321
Jared	<b>135</b>	110	93
Average retail price of merchandise sold	<b>\$368</b>	\$351	\$320
Kay	<b>\$317</b>	\$305	\$282
Regional chains	<b>\$332</b>	\$324	\$304
Jared	<b>\$719</b>	\$697	\$644
Average sales per store in thousands <sup>(3)</sup>	<b>\$2,089</b>	\$1,930	\$1,816
Kay	<b>\$1,815</b>	\$1,665	\$1,584
Regional chains	<b>\$1,517</b>	\$1,514	\$1,533
Jared	<b>\$5,676</b>	\$5,453	\$4,975
Increase in net new store space	<b>11%</b>	9%	8%
Percentage increase in like for like sales	<b>6.2%</b>	7.1%	5.9%

(1) 53 week year.

(2) Figures for stores opened during the year are adjusted for the impact of conversions of format between Kay and regional chains.

(3) Based only upon stores operated for the full financial year.

## US operating review (continued)

reward the achievement of specific targets with travel or additional cash awards. In addition to sales-based incentives, bonuses are paid to store managers based on store contribution and to district managers based on the achievement of key performance objectives. In 2006/07 approximately 23% (2005/06: 24%) of store personnel remuneration was commission and incentive-based.

US head office bonuses are based on the performance of the division against predetermined annual profit targets. Promotion and salary decisions for principally non-management head office personnel are based on performance against service level and production goals; for managers they are based on annual objectives and performance against individual job requirements.

### Store manager

Each store is led by a store manager who is responsible for various store level operations including overall store sales and branch level variable costs; certain personnel matters such as recruitment and training; and customer service. Administrative matters, including purchasing, merchandising, payroll, preparation of training materials, credit operations and divisional operating procedures are consolidated at divisional level. This allows the store manager to focus on those tasks that can be best executed at a store level, while enabling the business to benefit from economies of scale in administration and to help ensure consistency of execution across all the stores.

### Recruitment, retention and promotion

Although staff recruitment is primarily the responsibility of store and district managers, a central recruitment function supplies field recruiters from its US head office in Akron, Ohio. Methods such as internet recruitment are used to provide stores with a larger number of better-qualified candidates from which to select new staff.

Management believes that the retention and recruitment of highly-qualified and well-trained staff in the US head office is essential to supporting the stores. A comprehensive in-house curriculum supplements specific job training and emphasises the importance of the working partnership between stores and the head office.

A key motivator for all staff, and in particular for store based employees, is the division's practice of internal promotion. All district managers and Vice Presidents of Regional Operations have been a store manager within the division.

### Real estate

The vast majority of Signet's US stores are located in suburban areas. Kay and the regional chains are predominantly located in superior regional and super-regional enclosed malls where they seek sites at busy centre court locations. Around 60% of the stores are so situated. The average mall store contains approximately 1,190 square feet of selling space and 1,480 square feet of total space. The design and appearance of stores is standardised within each chain. The typical capital and working capital investment in the first year of trading to open a mall store is about \$1.2 million. In some of the highest traffic malls a "superstore" format is being selectively tested. This format draws on the US division's experience with Jared and the metropolitan stores by providing

increased selling space, better customer service facilities and a wider merchandise assortment, in particular a much greater selection of loose polished diamonds and settings. At 3 February 2007 there were 11 Kay superstores.

The typical Jared store has about 4,900 square feet of selling space and 6,100 square feet of total space. Its size permits significantly expanded product ranges and enhanced customer services, including in-store repair and custom design facilities. A private viewing room is available for customers when required. There are also complimentary refreshments and a children's play area. In the first year of trading a typical Jared store requires an investment of about \$3.9 million, of which 70% is working capital.

Management believes that the US division's prime real estate portfolio, together with its regular investment in mall store refurbishments and relocations, are competitive advantages that help build store traffic. Increased like for like sales growth is normally achieved for a number of years following such investment. The benefits from mall store refurbishments, which normally occur on a ten year cycle, include an increase in linear footage of display cases, more effective lighting and improved visibility. When relocating a store to a better location in a mall, such as a centre court corner site from an in-line location, an increase in like for like sales is expected for the reasons given above.

In 2006/07 there was a net increase in the US division's new store selling space of 11%, just above the top end of the target range. In 2007/08 it is planned to open approximately 20-25 Jared stores, 40-50 mall stores, 35-40 off-mall Kay locations, and five Kay stores in outlet centres. Around 15 mall stores are planned for closure. The programme should result in a net increase in new store space at the top end of the 8% – 10% annual growth target in 2007/08, and is discussed in more detail below. Management has identified the potential to almost double US selling space by continuing to focus on existing concepts.

### Store numbers

	3 February 2007	Planned net openings 2007/08	Potential
Kay:			
Mall	772	25-30	850+
Off-mall	52	35-40	500+
Outlet centres	5	5	50-100
Metropolitan	3	–	30+
	832	65-75	1,430+
Regionals	341	5	c.700
Jared	135	20-25	250+
Total	1,308	90-105	2,380+

### Investment criteria

Both the operational and financial criteria for investment in real estate remain stringent, the financial criteria being a positive net present value over a five year period on a pre tax basis using a 20% discount rate and assuming working capital is released after five years.

Signet may consider selective purchases of chains of mall stores that meet its acquisition criteria regarding location, quality of real estate, customer base and return on investment.

## Kay

The expansion of Kay as a nationwide chain is an important element of the US division's growth strategy. With 832 stores in 50 states at 3 February 2007 (28 January 2006: 781 stores), Kay is targeted at the middle income consumer and in 2006/07 had sales of \$1,486.7 million (2005/06: \$1,290.1 million). Since 2004/05 Kay has been the largest speciality retail jewellery brand in the US, based on sales, and has since increased its leadership position.

The average retail price of merchandise sold in Kay in 2006/07 was \$317 (2005/06: \$305).

Kay stores have historically been located in covered regional malls and it is believed that in the longer term there is potential to expand the chain to over 1,430 stores, including some 850 stores in such malls (3 February 2007: 772). Since 2002/03 Kay formats have been developed for locations outside traditional malls because management believes these sites present an opportunity to reach new customers who are currently aware of the brand but with no convenient access to a store, or for customers who prefer not to shop in a mall. Such stores will leverage further the strong Kay brand awareness, the marketing support and the central overhead. These formats are detailed below.

### Off-mall locations

Kay lifestyle and power strip stores provide an expansion opportunity to take advantage of fast growing retail venues. A lifestyle location is in a suburban open air shopping centre where the retail mix is biased toward fashion and leisure stores and is also likely to have a large number of restaurants and a multi-screen movie theatre. A power strip centre is also a suburban open air shopping complex but the retail mix is predominantly category killer superstores with some smaller speciality units. These types of shopping centre are referred to as "off-mall" locations.

Kay stores in off-mall locations were successfully tested between 2003/04 and 2005/06 with 31 stores having been opened. The roll-out of Kay stores in these open air centres began in 2006/07 with 21 openings and it is planned to open 35–40 in 2007/08. The potential for over 500 suitable locations has been identified in such types of centres. While these Kay stores are expected to have a lower capital expenditure, lower rents and lower sales per store at maturity than that of the Kay chain average, they are anticipated to satisfy the normal return on investment hurdle set by the Group.

### Outlet locations

During 2006/07 four Kay stores were opened in outlet malls. These stores provide penetration into the value conscious sector of the market and are located in two types of centres: "Factory outlets" in which 50% or more tenants are manufacturers' outlets; and "Mixed use" centres, typically with one million square feet of manufacturers' outlet units, traditional mall stores and large space retailers. The core merchandise is the same as in all other Kay stores, as is the pricing structure, but the range of such outlet locations is supplemented by clearance merchandise rather than fashion product. At 3 February 2007 there were five Kay stores in outlet locations and a further five are planned to be opened in 2007/08.

## Metropolitan locations

Kay metropolitan stores allow penetration into high population downtown areas under-served by the division's typical mall and off-mall stores. These metropolitan markets have a high density of retail, business, entertainment and government establishments with good transit services and high pedestrian footfall. While the performance of the three stores opened to date has been satisfactory, a major constraint to the development of this type of store is availability of real estate that satisfies both operational and financial investment criteria.

These Kay stores are anticipated to have a higher capital expenditure, higher rents and higher sales per store at maturity than that of the Kay chain average. The development of these stores draw on the division's experience gained from both Kay and Jared.

## Regional chains

Signet also operates mall stores under a variety of established regional trade names (see Description of property, page 24). The leading brands include JB Robinson Jewelers, Marks & Morgan Jewelers and Belden Jewelers. At 3 February 2007 341 regional chain stores operated in 33 states (28 January 2006: 330 stores) and sales for 2006/07 were \$501.0 million (2005/06: \$484.5 million). Nearly all of these stores are located in malls where there is also a Kay store. The average retail price of merchandise sold in a regional store during 2006/07 was \$332 (2005/06: \$324).

New regional chain stores are opened if real estate satisfying the division's investment criteria becomes available in their respective trading areas or in adjacent areas where marketing support can be cost effective. Areas in which the scale to support cost-effective marketing can be built over a reasonable time span are also considered for store openings. Management believes that there is potential to develop a second mall-based brand of sufficient size to take advantage of national television advertising. During 2006/07, 19 stores that had operated under two other regional brand names were converted to the JB Robinson facia in areas in which the expanded trial of local television advertising took place. At 3 February 2007 there were 114 JB Robinson stores. To accelerate the formation of a second national mall brand, acquisitions of small or large regional chains, or a national chain, of speciality jewellery stores that meet the Group's strict operational and financial criteria are considered.

## Jared

Jared is the leading off-mall destination speciality retail jewellery chain in its sector of the market. Its main competitors are independent operators, with the next largest chain having about 25 stores. Jared is the fourth largest US speciality jewellery retail brand by sales. The first Jared store was opened in 1993.

Jared locations are typically free-standing sites in shopping developments with high visibility and traffic flow, and positioned close to major roads. The retail centres in which Jared stores operate normally contain strong retail co-tenants, including other category killer destination stores such as Borders Books, Best Buy, Home Depot and Bed, Bath & Beyond, as well as some smaller speciality units.

## US operating review (continued)

The following map shows the number and locations of Kay, Jared and Regional stores at 3 February 2007.



Jared targets an under-served sector at the upper end of the middle market. This customer is more mature and has a higher income than that of Signet's US mall store customer. An important distinction of a destination store is that the potential customer visits the store with the intention of making a jewellery purchase, whereas in a mall there is a greater possibility that the potential shopper is undecided about the product category in which they will make a purchase.

There were 135 Jared stores at 3 February 2007 (28 January 2006: 110 stores) and sales in 2006/07 were \$664.4 million (2005/06: \$534.2 million). The average retail price of merchandise sold in Jared stores during 2006/07 was \$719 (2005/06: \$697), which was more than double that of a Signet US mall store.

In the first five years of trading a Jared store is projected to have a faster rate of like for like sales growth than that of a mall store during the same period. At the end of this period the projected sales level is \$5 million to \$6 million and the expected operating margin is comparable to that of a mall store at maturity, with a

greater return on capital employed. The average sales of the 55 Jared stores that have traded through the five year period forecast in the investment models is \$5.6 million in their fifth full year. At 3 February 2007 some 69% of the Jared stores had been open for less than six years. The average sales per Jared store opened for the whole of 2006/07 was \$5.7 million (2005/06: \$5.5 million). The average sales per store for those locations that have been open for six or more years was \$6.8 million in 2006/07.

Since the first Jared store opened, the concept has been continually evaluated, developed and refined. Management believes that compared to its competitors, Jared benefits from leveraging the division's established infrastructure, access to a pool of experienced store management, and availability of capital required to develop and grow the brand.

In the longer term, the chain has the potential to expand nationwide to over 250 stores, generating annual sales of over \$1.5 billion based on the current performance of existing Jared stores.

## Merchandising and purchasing

It is believed that selection, availability, and value for money of merchandise are all factors that are critical to retail success. In the US business, the range of merchandise offered and the high level of stock availability are supported centrally by extensive and continuous research and testing. Best-selling products are identified and their rapid replenishment ensured through analysis of sales by stock keeping unit. This approach enables the division to deliver a focused assortment of merchandise to maximise sales, minimise the need for discounting and accelerate inventory turn. Further the US division is better able to offer superior value and consistency of merchandise than its competitors due to its direct sourcing capability.

### Inventory management

Sophisticated inventory management systems for merchandise testing, assortment planning, allocation and replenishment have been developed and implemented. Approximately 75% of the merchandise is common to all US division mall stores, with the remainder allocated to reflect demand in individual stores. It is believed that the merchandising and inventory management systems, as well as improvements in the productivity of the centralised distribution centre, have allowed the division to achieve inventory turns at least comparable to those of competitors, even though it has a significantly less mature store base and undertakes more direct sourcing of merchandise.

### Merchandise mix

In 2006/07, the bridal category accounted for about 45% of merchandise sold and its participation in the sales mix has grown steadily over the past five years.

Programmes have been developed in conjunction with certain vendors for the provision of branded jewellery merchandise. For example, the Leo Diamond range is sold exclusively by Signet in the US and the UK; the "Peerless Diamond", an Ideal Cut diamond with a superior return of light, exclusive to the Group, has been rolled out to all Jared locations; and "Le Vian", a prestigious fashion jewellery brand with a 500 year history, is now sold in all Kay and Jared stores. Management believes that the US division's merchandising process, market share and relationship with suppliers, position the business as an ideal partner to develop branded initiatives.

The table below sets out Signet's US merchandise sales mix as a percentage of sales:

### Merchandise mix

	Percentage of sales		
	2006/07 %	2005/06 %	2004/05 %
Diamonds and diamond jewellery	72	71	70
Gold jewellery	7	7	7
Gemstone jewellery	9	9	10
Watches	7	7	7
Repairs	5	6	6

### Direct sourcing of polished diamonds

It is believed that the US division has a competitive cost and quality advantage as diamond merchandise sold is sourced through contract manufacturing; Signet purchases loose polished diamonds on the world markets and outsources the casting, assembly and finishing operations to third parties. By using this approach the cost of merchandise is reduced and the resulting advantage is largely used to provide superior value to the consumer which helps to increase market share. Contract manufacturing is generally utilised on basic items with proven non-volatile historical sales patterns that represent a lower risk of over or under-purchasing.

Contract manufacturing accounted for some 48% of diamond merchandise sold in 2006/07. In prior years it had been about 55%. The lower level in 2006/07 reflects the strength of the newly introduced "Circle" and "Journey" ranges. It is anticipated that the proportion of contract manufacturing will increase from the 2006/07 level in future.

The contract manufacturing strategy also allows the buyers to gain a detailed understanding of the manufacturing cost structure and improves the prospects of negotiating better pricing for the supply of finished products.

### Rough diamond initiative

In 2005/06 a multi-year trial, involving the purchase and contract polishing of rough diamonds, was commenced. In 2006/07 it was expanded. This trial is still at an early stage and the US division continues to purchase about 50% of the diamonds it sells as polished loose diamonds. In 2007/08 it is planned that the capability to purchase rough diamonds will be taken to the next stage of development. Once these stones have been cut and polished on a contract basis, they enter the US division's supply chain in a similar way to other polished loose diamonds. Stones not suited to the Group's merchandise selection are sold to third parties. In 2007/08 it is planned to increase further the volume of rough diamonds purchased.

The objectives of this supply chain initiative are to:

- secure additional reliable and consistent supplies of diamonds to support the growth of Signet's US business;
- offer customers superior value and consistency of merchandise quality;
- improve understanding of the polished diamond market; and
- reduce costs.

### Sourcing of complete merchandise

Certain merchandise is purchased complete as a finished product where the complexity of the product is great or the merchandise is considered likely to have a less predictable sales pattern. This strategy provides the opportunity to reserve stock held by vendors and to make supplier returns or exchanges, thereby reducing the risk of over or under-purchasing.

Direct sourcing of complete merchandise from overseas accounts for about 7% of merchandise in 2006/07 and consideration is being given to increasing this proportion.

## US operating review (continued)

### Merchandise held on consignment

Merchandise held on consignment is used to enhance product selection and test new designs. This minimises exposure to changes in fashion trends and obsolescence and provides the flexibility to return non-performing merchandise. At 3 February 2007 the US division held approximately \$205 million (28 January 2006: \$174 million) of merchandise on consignment (see note 13 on page 92).

### Suppliers

In 2006/07 the five largest suppliers collectively accounted for approximately 20% (2005/06: 22%) of the total US division's purchases, with the largest supplier accounting for approximately 9% (2005/06: 10%).

### Marketing and advertising

Store brand name recognition by consumers is believed to be an important factor in jewellery retailing, as the products themselves are predominantly unbranded. Signet continues to strengthen and promote its US brands and build name recognition through an integrated marketing campaign. The marketing channels used include television, radio, print, catalogues, direct mail, telephone marketing, point of sale signage, in-store displays and the internet. Gross advertising and marketing expenditure increased by 20.7% to \$184.5 million over the 53 weeks to 3 February 2007 (52 weeks to 28 January 2006: \$152.8 million), reflecting the sales growth achieved by Kay, the regional brands and Jared. Over the last five years, advertising and marketing expenditure has increased by some 80%. Gross expenditure as a percentage of sales was 7.0% (2005/06: 6.7%) reflecting the increasing proportion of sales from Jared which has a higher percentage of sales spent on marketing than the mall brands, and the impact of the 53rd week which includes the commencement of television advertising for Valentine's Day in 2007.

Advertising activities are concentrated during periods when customers are expected to be most receptive to the marketing message. The proportion of television advertising expenditure to sales continues to grow, and the cost of national television advertising is leveraged as the number of stores increases.

### Kay television advertising

The romance-and-appreciation-based theme of Kay's television advertising programme continues to utilise the tag line "Every kiss begins with Kay", which has improved name recognition of the chain. This programme was supplemented with national print advertising in USA Today and national network radio advertising.

Management believes that use of national television advertising, which is considered to be the most efficient and cost-effective form of marketing, enhances brand name recognition nationwide, thus providing increased marketing leverage and improved access to prime store real estate sites in large, high cost advertising markets.

### Regional brands television advertising

Local television advertising was tested in the Cleveland, Ohio market for JB Robinson during Christmas 2005 and expanded in 2006/07 to three additional markets. This is designed to

complement seasonal promotion campaigns using local radio advertising. Direct mail and telephone marketing are also used to encourage repeat purchases by current customers. The regional brands' marketing support is a similar proportion of sales as for Kay.

### Jared television advertising

Jared advertising on local radio takes place for most of the year and is complemented during key trading periods by advertising on television. For Christmas 2006 Jared advertised nationally on cable television for the first time. National broadcast television advertising for Jared is planned to start during the fourth quarter of 2007/08. Jared has a higher advertising to sales ratio than the division's mall stores because it is a destination store and is still at an early stage of development. Jared advertising is designed to build name recognition and visit intent through an emphasis on selection and service and utilises the tag line "He went to Jared".

### Other marketing channels

In 2006/07 the US division produced ten Kay catalogues that featured a wide selection of merchandise and were prominently displayed in stores and are also mailed directly to targeted customers. A similar number of catalogue editions were produced for each regional brand. Statistical and technology-based systems are employed to support a direct marketing programme that uses a proprietary database of over 24 million names to strengthen the relationship with customers. The programme targets current customers with special savings and merchandise offers during the key trading periods. In addition, invitations to special in-store promotional events are extended throughout the year. A special catalogue featuring luxury watches was produced for Jared.

A new Kay website including a transactional capability was launched in September 2006 and has had an encouraging start. Informational websites for Jared, JB Robinson and a number of the other regional brands display a selection of merchandise assortments, provide store locations, and allow for on-line customer registration and credit application.

### Credit operations

In the US jewellery market it is necessary for speciality retailers to offer credit facilities to the consumer. Management regards the provision of an in-house credit programme, rather than one provided by a third party, as a competitive advantage for a number of reasons:

- authorisation and collection models are based on the behaviour of the consumer to the division;
- it allows management to establish and implement customer service standards appropriate for the business;
- it provides a database of regular customers and their spending patterns;
- investment in systems and management of credit offerings appropriate for the business can be facilitated; and
- superior cost effectiveness by utilising in-house capability.

Furthermore the various credit programmes help to establish long-term relationships with customers and complement the marketing strategy by enabling additional purchases, higher units per transaction and greater value sales.

The table below presents data related to the in-house credit business for the past three financial years. Since credit authorisation and collection systems were centralised in 1994 the credit terms and performance have been relatively consistent over the economic cycle. The average outstanding balance at the year end was \$957 (2005/06: \$841).

The credit portfolio turns approximately every seven months and the monthly collection rate in 2006/07 was 14.6% (2005/06: 14.5%). The bad debt charge for the year, at 5.3% (2005/06: 5.8%) of credit sales, was at the bottom end of the historic range. In-house credit sales represented 51.7% of total US sales in 2006/07 (2005/06: 51.6%). A number of programmes offer interest-free financing of less than one year's duration, subject to certain conditions and these account for a significant proportion of credit sales. In most US states customers are offered optional third party credit insurance.

Authorisation and collections are all performed centrally at the US head office, rather than by store staff. The majority of credit applications are processed and approved automatically; they can and are initiated via in-store terminals, through a toll-free phone number or on-line through the division's websites. All applications are evaluated by the scoring of credit data and using data obtained through third party credit bureaux.

Investment in staff, training and systems to maintain or improve the quality of the credit portfolio continued in 2006/07. In 2005/06 a customised collection system was fully implemented which replaced one initially installed when credit operations were centralised. The system provided management with flexibility to implement and/or modify collection strategies, through a user-friendly platform. Collection strategies and efforts continued to include emphasis on risk-based calling and first call resolution. In authorisations, new applicant scorecards were updated to provide improved separation in evaluating high and low-risk applicants and to increase activation rates with preferred customers to encourage higher sales.

In addition to in-house credit sales, the US stores accept major credit cards. Third party credit sales are treated as cash sales and accounted for approximately 39% (2005/06: 38%) of total US sales during the year.

## Management tools and communications

The US division's highly integrated and comprehensive information systems provide detailed, timely information to monitor and evaluate virtually every aspect of the business and are designed to decrease the time sales staff spend on administrative tasks and increase time spent on sales activities. They also support merchandise testing, loss prevention and inventory control.

All stores are supported by the internally developed Store Information System, which includes electronic point of sale ("EPOS") processing, in-house credit authorisation and support, a district manager information system and constant connectivity for all retail locations for data communications including e-mail. The EPOS system updates sales, in-house credit and perpetual inventory replenishment systems throughout the day for each store.

The store communications system is planned to be upgraded to broadband during 2007/08.

## Regulation

Signet US is required to comply with numerous US federal and state laws and regulations covering areas such as consumer protection, consumer privacy, consumer credit, consumer credit insurance, truth in advertising and employment legislation. Management endeavours to monitor changes in these laws to ensure that its practices comply with applicable requirements.

	2006/07 <sup>(1)</sup>	2005/06	2004/05
Credit sales (\$m)	<b>1,372.1</b>	1,191.2	1,055.2
Credit sales as % of total sales	<b>51.7%</b>	51.6%	51.2%
Number of active credit accounts at year end	<b>896,289</b>	883,873	838,916
Average outstanding account balance (\$)	<b>957</b>	841	792
Average monthly collection rates	<b>14.6%</b>	14.5%	14.8%
Bad debt as % of total sales	<b>2.8%</b>	3.0%	2.8%
Bad debt as % of credit sales	<b>5.3%</b>	5.8%	5.5%

(1) 53 week year.