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Signet Jewelers Ltd. (SIG)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to the Signet Jewelers First Quarter Fiscal 2021 Earnings Call. [Operator Instructions] Please note, today's event is being recorded.

And I would like to turn the conference over to your host today, Vinnie Sinisi. Please go ahead, sir.

Vincent J. Sinisi
Senior Vice President-Investor Relations, Signet Jewelers Ltd.

Hey, great. Thanks very much, Keith. Good morning, everyone, and welcome to our first quarter earnings conference call. On the call today are: Signet's CEO, Gina Drosos; and CFO, Joan Hilson.

During today's presentation, we will make certain forward-looking statements. Any statements that are not historical facts are subject to a number of risks and uncertainties, and actual results may differ materially. We urge you to read the risk factors, cautionary language and other disclosure in our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. Except as required by law, we undertake no obligation to revise or publicly update forward-looking statements in light of new information or future events.

During the call, we'll discuss certain non-GAAP financial measures. For further discussion of the non-GAAP financial measures, as well as reconciliation of those non-GAAP financial measures to the most directly comparable GAAP measures, investors should review the news release we posted on our website at www.signetjewelers.com/investors.

And with that, I'll turn the call over to Gina.

Virginia C. Drosos
Chief Executive Officer & Director, Signet Jewelers Ltd.

Thank you, Vinnie. Good morning, everyone, and thank you for joining us on our call today. Before we get into our results, I wanted to share a few thoughts on the events of the past few weeks. While these are truly unprecedented times, from the global COVID-19 pandemic to economic uncertainty, nothing has matched the pain and heartache of yet another brutal murder of an unarmed person of color. This pattern of discrimination and violence must stop now. Racism has no place in our world, and certainly, not in a country dedicated to protecting life, liberty and the pursuit of happiness for all.

Always and particularly in this context, I'm extremely proud of what Signet stands for. We immediately denounced these hateful acts and made a substantial donation to the NAACP Legal Defense and Educational Fund. I am also hosting an open-mic townhall with Signet team members next week, called Signet Speaks Out, with the intention that a frank discussion on race will give us new and meaningful actions we can take to improve within our four walls. We will continue this open dialogue throughout the year and look to leverage our actions and insights to also help lead change in our industry and communities. At Signet, our mission is to celebrate life and express love. And we are committed to making this true for all people.

Now, I'll move on to a discussion of our Q1 performance. This quarter, I'll open my remarks with an assessment of Signet's competitive positioning in the post-COVID-19 world. I'll provide thoughts on our key strategic priorities and our acceleration over the last two months to a more effective and efficient Omnichannel retailer. I'll then turn the call over to Joan for financial commentary on the first quarter and fiscal 2021.

Signet came into the fiscal year with strong momentum. Prior to the pandemic, we delivered strong results during the Valentine's Day selling period, and ended February with solid comps in the low-single digits as disruption from COVID-19 began. Focusing first on the health and safety of our employees and customers, and in full compliance with government mandates, we temporarily closed all stores in late March. We took immediate actions to ensure the financial stability of our company and pivot to a much stronger digital experience for our customers.

I'd like to now frame Signet's actions in the context of the larger jewelry category. The jewelry retail market is highly fragmented with an underpenetrated presence in digital. Signet has roughly 6% market share in the US and the number one share in all markets in which we operate. Thousands of independent jewelry stores hold roughly 70% of US market share.

One of Signet's greatest strengths is one we share with independent jewelers, the trust that comes from significant jewelry expertise and long-term relationships, and we do it at scale. In fact, across the country, our jewelry consultants help young couples celebrate an engagement and then support their lifetime of jewelry gifts, including birthdays and anniversaries. They help with meaningful statements of self-expression and spontaneous on-trend fashion purchases.

What this crisis is reinforcing, is that those relationships combined with our scaled digital platform investments have allowed us to pivot quickly. We've been able to transfer these relationships into virtual consultations and help our customers buy online. Signet's shopping journey has never been more integrated across the breadth of our physical and virtual touch points, creating what we believe is a long runway of opportunity ahead for Signet to grow revenue and market share as the leading Omnichannel retail jewelry company.

Here are some examples. Since COVID-19, our store teams have personally reached out to more than 23 million customers, held over 100,000 virtual appointments and have been successful in meeting customers' needs even while stores were closed. In Q1, site traffic increased 20% over last year, despite reducing our advertising spend. Our virtual consultations are resulting in multifold higher conversion rates than direct eCommerce traffic alone.

Q1 eCommerce growth was 18.2%, excluding the impact of the shutdown of James Allen's New York City distribution center due to COVID 19. eCommerce growth accelerated through the quarter to 55% in April, excluding James Allen. And momentum has continued into the second quarter with a strong Mother's Day selling season and the addition of some alternate sourcing for James Allen.

We believe that virtual selling will become a sustainable part of a uniquely desirable and integrated shopping journey provided by Signet. We will invest to continuously improve our digital experience, while bringing the best of our stores online and the best of our digital offering into stores. We believe that our increasing sales momentum shows that while some of life's moments may physically be on hold, our customers have never needed to celebrate those moments more than now. And Signet is meeting their needs whenever and wherever they want to shop.

Turning to real estate. As of yesterday, we have approximately 1,100 stores open to the public. Store performance is better than expected with revenue able to cover four-wall operating costs rather quickly. We are continuing to accelerate the pace of store openings based on the safety of our employees and customers and government regulations. We appreciate the incredible agility and urgency of our store teams to implement cleaning protocols to ready our stores for our customers and to make them continually safe places for people to shop and try on jewelry.

As you know, over the last few years, as part of our Path to Brilliance strategy, we reduced our store footprint by 13%, largely moving out of all D malls and regional banners. Now, in the current environment, we are accelerating our optimization efforts, further reducing our exposure to declining C and B malls. As a result of a result of a full market assessment, one which included a greenfield analysis of customer trade areas specific to jewelry, we are announcing that we will not reopen at least 150 stores in North America and 80 in Europe. Furthermore, we are committed to closing at least an additional 150 stores this fiscal year, with these closures, bringing the cumulative footprint reduction to more than 20%.

With a focus on store profitability, we remain in active discussions with our landlord partners to negotiate rent payments and go-forward occupancy costs. We are also testing re-imagined uses of our physical footprint, such as combined Jared and James Allen locations and outlet stores that house multiple banners. We look forward to providing further updates on these and other location and format tests over the course of this year.

Turning to merchandising, from an assortment perspective, we continue to rationalize SKUs and focus on fewer, bigger new product launches; on-trend product offerings, like gold and color; and excellent values for our customers. We ended Q1 with inventory flat to last year's reduced levels. We hosted notable virtual events on key brands, like Le Vian and gifts for Mother's day and have upcoming key launches ready for summer and holiday selling seasons. Using our enhanced digital platform, we continue to optimize our targeted marketing techniques to maintain relationships with existing customers and capitalize on new customer acquisition opportunities with improved efficiency.

Turning to cost savings. Over the first two years of Path to Brilliance, we delivered $185 million in net cost savings, enabling us to fund digital investments, mitigate headwinds and improve our cash and profitability. This positions us to exceed our initial three-year transformation goal of $200 million to $225 million in cost reductions. Furthermore, since COVID-19, we have identified more than $100 million of additional structural cost savings within this fiscal year, which we expect to continue into out-years as well.

Turning to liquidity, as discussed last quarter, we took rapid steps to preserve cash. We currently have $1.1 billion in cash and equivalents and had negative free cash flow of only $15 million in the quarter. While we never could have anticipated the last few months and the obvious impact on revenue, with stores closed for almost half the quarter, the first two years of our Path to Brilliance transformation provided us with a strong foundation to rapidly build on.

A sage mentor of mine once said, never waste a crisis. And we've embraced that full on. Year three, amidst COVID-19, has been an opportunity to accelerate the momentum of key strategic initiatives. We've made substantial progress on key elements of our customer-first strategy, like targeted marketing and a more relevant and curated merchandise assortment.

We've advanced our Omnichannel journey with new digital tools, in-depth virtual consultation and store footprint optimization. And we've embraced rapid testing and learning with agility, and doubled down on efficiency efforts with lasting cost structure improvements. Our team is energized by the opportunity to serve our customers differently. And we are relentlessly focused on emerging from this crisis as a stronger Signet team and company.

And now, I'll turn the call over to Joan.

Joan Holstein Hilson

Chief Financial Officer, Signet Jewelers Ltd.

Thanks, Gina; and good morning, everyone. In my remarks, I'll discuss highlights of our first quarter financial results. I'll also review actions we have taken to conserve cash in response to COVID-19 and provide an update on our credit portfolio partners.

To note, for the first quarter, in light of the unprecedented times, we will provide additional details around our intra-quarter performance. We do not intend to provide these details going forward, but thought it would be helpful for Q1. As Gina mentioned earlier, we saw accelerating eCommerce momentum throughout Q1 and into the Mother's Day selling season. Brick-and-mortar same-store sales declined 44.7%, with temporary store closures beginning in late March.

Adding some additional color, in February, same-store sales were running positive low-single digits. And we grew our eCommerce sales by 11% compared to the prior year, reflecting strong Valentine's Day performance. We then pivoted in late March to an eCommerce-only retailer. It was at this point that we increased our digital outreach to customers, as well as implemented our virtual appointment process.

Gross margins of $204.2 million declined as a result of lower sales from the COVID-19 pandemic, which led to a deleveraging on fixed costs. This decline was partially offset by cost reductions and lower occupancy costs. We note that we were able to hold gross merchandise margins consistent to last year.

SG&A expense declined significantly driven by lower labor costs, resulting from employee furloughs, temporary pay reductions, lower advertising expenses and overhead reductions. This resulted in a non-GAAP operating loss of $142.5 million for the quarter.

GAAP operating loss was $291.1 million and includes $136.3 million of pre-tax impairment of goodwill, intangibles and long-lived assets. As discussed in the earnings release, the Q1 financial statements are preliminary due to the long-lived noncash asset impairment review necessitated by the COVID-19 pandemic.

Interest expense declined 23% year-over-year, reflecting our 2019 refinancing. Our Q1 non-GAAP effective tax rate of 50.4% represents projected benefits related to the application of certain reliefs provided under the CARES

Act. We estimate we'll receive a cash benefit as a result of NOL carrybacks. First quarter non-GAAP EPS was a loss of $1.59 compared to prior-year non-GAAP EPS of $0.08.

As a reminder of our cash preservation, I'd like to quickly review the immediate actions we took to increase our financial flexibility in the COVID environment. Specifically, we reduced marketing and discretionary corporate spending. Our executives and board of directors took voluntary compensation reductions. We expect to reduce capital expenditures by approximately 50% versus last year and will prioritize initiatives that support our digital efforts.

Inventory management is also a key factor in our financial flexibility. We worked with our vendor partners to extend payment terms and establish go-forward agreements with key strategic vendors. We continue to sell through clearance merchandise, cut planned receipts and are implementing initiatives in support of our flexible fulfillment efforts, all aimed at inventory efficiency. The result of these efforts was free cash flow of negative $15 million in Q1, with cash and equivalent balance of $1.1 billion. Finally, our common dividend remains suspended, as does our financial guidance, until we have greater market clarity. The August preferred dividend will be paid in kind.

Now I would like to briefly provide an update on our non-prime credit offering. With respect to the non-prime, forward flow receivables representing approximately 7% of Signet's annual sales last year, Castlelake and CarVal have agreed to continue to purchase receivables for existing customer accounts that have or previously had a receivables balance through June of 2021, unless terminated earlier by either party.

We have agreed to extend the payment due Signet of the remaining 5% for the back book receivables purchased in 2018 until the agreements terminate. The company is now retaining receivables opened by new customers, which are expected to be less than 2.5% of the company's fiscal 2021 revenue. The company's agreement with the credit servicer, Genesis, remains in place.

Before I turn the call over to Q&A, I'd like to reiterate that we feel confident in our financial positioning. We intend to continue to preserve cash, reduce structural costs, and target investments and initiatives that will allow us to emerge from this crisis with a plan to further optimize our virtual and physical footprints.

And now, I'll turn the call over to the operator to begin the Q&A session.

QUESTION AND ANSWER SECTION

Operator: Yes. Thank you. [Operator Instruction] And the first question comes from Paul Lejuez with Citi.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc. Q

Hey. Thanks, guys. Wondering if you could provide any further quantification on what you're seeing in the performance of the stores that have now reopened. I think, you said something about revenue covering operating costs. Curious if that means that those stores are already four-wall breakeven. Is that one and the same? And then, also, of the 150 stores that won't reopen, as well as the additional 150 to be closed, can you talk about the sales and EBIT contribution from those two classes? Thanks.

Virginia C. Drosos
Chief Executive Officer & Director, Signet Jewelers Ltd. A

Hi, Paul. It's Gina. I'll take the first part of that question. So, our plan to reopen stores has been actually similar to how we closed stores. We've been using a hyper-local approach based on market dynamics and analysis of all the government mandates, et cetera. And we are, based on the results that we've seen early on, opening stores as quickly and safely as we can.

The performance of our reopened stores has been exceeding our expectations. And, yes, you heard what I said in the script, right, the revenue is covering the operating expenses on a four-wall basis. So, we intend to carry forward the strides that we've made in digital capabilities, doing more appointment booking, and really leveraging that new integrated Omnichannel experience as we reopen more stores. Our plan is to have at least 75% of the fleet open by the end of June.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd. A

And then, Paul, with respect to the second question, our valuation of stores that will not reopen, the 150 stores, really stems from the greenfield analysis and the overall evaluation of our go-forward physical footprint. We're not disclosing at this time what the sales and operating contribution of those stores are, but we feel confident that the footprint that we see on a go-forward basis is the one that is best for us.

Virginia C. Drosos
Chief Executive Officer & Director, Signet Jewelers Ltd. A

The one thing I'd add to this is that we've historically done our analysis on closing stores really on an internally focused basis, looking at the contribution and profitability of those stores. What we've done differently this time that I actually think is a more breakthrough way to look at it, is that we have mapped the country in a greenfield analysis, almost a clean sheet of paper to say, if we were starting today, which markets justify one store, two stores, three stores or more and where would we put them. And we've used that customer-first lens to really decide what our future store footprint should look like.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc. Q

Thanks. And just to go back on the commentary you made about the receivables. Am I correct in understanding that the non-prime receivables will now come back on the balance sheet? As we think about Signet in the future and F21 and beyond, you guys will carry those receivables, no change to the prime piece of the equation?

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

There's no change to the prime. The non-prime, CarVal and Castlelake will continue to purchase add-ons for the existing accounts. What will come on to – what Signet is purchasing is new accounts – new account purchases. And what I indicated there, that it was roughly 2.5% of sales, is our expectation.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Got you. Thanks. Good luck.

Operator: Thank you. And the next question comes from Dana Telsey with Telsey Advisory.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

As you think about the gross margin and the SG&A, the gross merchandise margin being consistent with last year, can you unpack the buckets of each and what you're seeing there? And as you think about costs coming back, do you need all the store staff that you had been, or do you operate with a leaner staff, whether it's given more limited occupancy in stores and also the – what you've been seeing in virtual appointments? Thank you.

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

Thanks, Dana. So, with respect to gross merchandise margin, it was consistent for us over the quarter. We feel that in that quarter itself over the first quarter, that we had a very nice balance of regular price selling. We had clearance selling. And we were able to leverage a lot of the value-priced items for Valentine's Day that we saw serve us well over the holiday selling season in the fourth quarter. So as we look forward and think about gross merchandise margin and our inventory, we will continue to consider strategic promotions, working through our clearance inventory and balancing the bigger, fewer launch products that Gina mentioned in her prepared remarks.

Then, with respect to the structural cost savings, as we operate our stores today, we recognize that business is performing and behaving differently than it had pre-COVID. We have evaluated operating hours. We have evaluated store staffing. We have virtual selling that Gina mentioned in her script. So, these are the points of evaluation that are helping us to really take structural costs out of our SG&A. And that's just a few things related to labor that we are really evaluating and putting in place as we roll forward our stores and our store opening program.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Got it. And the...

Virginia C. Drosos
Chief Executive Officer & Director, Signet Jewelers Ltd.

A

The other thing I'd...

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Sorry.

Virginia C. Drosos
Chief Executive Officer & Director, Signet Jewelers Ltd.

A

Dana, the other thing I would – yeah, the other thing I'd mention is, Joan, who just celebrated a little bit ago her one-year anniversary with Signet, has brought us a number of new capabilities. And one of those is a true zero-based budgeting approach. And so, we continue to focus on costs that customers don't see or care about. But the kind of savings that we're now seeing in indirect spend are very meaningful. And so, I'd say, that's a big focus of the structural cost savings going forward.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

And occupancy expenses of existing stores remaining, is there opportunity there?

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

Dana, we have been working very strategically with our landlord partners and developers. And we have been able to work through a number of situations that made sense for both of us in terms of a reduction of rents in specific locations. And we'll continue to work with them collaboratively as we move through this reopening.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Thank you.

Operator: Thank you. And the next question comes from Lorraine Hutchinson with Bank of America.

Lorraine Hutchinson
Analyst, BofA Securities, Inc.

Q

Thanks. Good morning. I wanted to ask about the credit penetration rate, was down on a year-over-year basis. Have you seen any reluctance on ADS's part to lend, given the volatile macro climate?

Joan Holstein Hilson
Chief Financial Officer, Signet Jewelers Ltd.

A

Well, what I would say, Lorraine, to that is that, when you think about the mix of business that we had in the first quarter was we moved to an eCommerce-only channel for a good period of time. The mix of credit on eComm is lower. And so, we do not offer leasing online at this time. We are implementing that and expect to have it in roughly September of this year. So, that's really what is driving the credit penetration rate.

Lorraine Hutchinson
Analyst, BofA Securities, Inc.

Q

Thank you. And can you comment on your engagement or bridal trends as you started the year?

Virginia C. Drosos

Chief Executive Officer & Director, Signet Jewelers Ltd.

A

Sure. So we've actually seen that customers are still very interested in getting married. Our research indicates that more than half of customers are coming out of their quarantine period, feeling better about their relationships than they did before. And we launched not too long ago, a Jared Virtual Wedding program. And I'll tell you, within 72 hours, we had over 500 people signed up to do virtual weddings. So, we have in the numbers, but also in consumer sentiment, seen some strengths in the bridal business.

Lorraine Hutchinson

Analyst, BofA Securities, Inc.

Q

Thank you.

Operator: Thank you. [Operator Instructions] And the next question comes from Ike Boruchow with Wells Fargo.

Ike Boruchow

Analyst, Wells Fargo Securities LLC

Q

Hey. Good morning, everyone. Hope you're all doing well and staying safe. So, I guess, Joan, I just had a couple of questions on the credit. Maybe just to make sure I understand exactly what's going on.

So, first, in March, I thought it was just CarVal that was terminating. And now, it sounds like it's CarVal and Castlelake. I believe, in March, Castlelake had been planning on terminating. And so, I guess, I'm trying to understand what exactly has changed between then and now? And then, two other quick follow-ups. The 2.5% of sales, is that last year's sales or this year's sales? Because, obviously, the sales base is going to be dramatically different.

And then, the last one is maybe for Gina, which is, I guess, a higher-level question on credit. I know it doesn't sound like a lot in dollars, but I mean, the company went through in a period of time of having subprime receivables on the balance sheet and opted to try to get out of it, and there's a lot of volatility. I guess, what's the thought process around doing that versus just kind of letting that revenue kind of just go away and focusing more on the prime customer? Thanks. Sorry for all the questions.

Joan Holstein Hilson

Chief Financial Officer, Signet Jewelers Ltd.

A

Okay. I'll start, Gina. With respect to CarVal/Castlelake, that's accurate, Ike. CarVal did terminate in late March. Castlelake had not terminated at that time. As we progressed through conversations with both parties, what – the agreement that we've established today is that both parties, CarVal and Castlelake, will purchase add-ons to the existing accounts, with both of those parties. Signet is going to purchase the new receivables. And in keeping with that, that was 2.5% on a mix basis. That's an expectation. That's what it was for fiscal 2020.

From the perspective of how do we see this go forward and a little bit to respond to your question of Gina, we are offering additional financing alternatives for our customers. We believe that there's a full suite of services, one of which is closed-end loans, which we are piloting currently online. And there's also progressive leasing product that we have in stores and adding online in September. So, we believe that this suite of offering is – gives us a full suite and helps us to continue to serve our customers with many financing options and really don't see that as a negative.

Virginia C. Drosos
Chief Executive Officer & Director, Signet Jewelers Ltd.

A

Yeah. So, if I just build on what Joan said to answer the strategic question, I think, four things: Number one, we see this as a moment in the market for new customer acquisition. And so, controlling that part of the book, we think, really gives us a strategic competitive advantage. Number two, we have new predictive models in place, models that didn't exist when Signet owned the entire portfolio before. And that is allowing us to better manage to whom we lend and make that more strategic.

Number three, as Joan mentioned, we have new tools. So, we can direct our lower FICO customers into tools, like leasing, which grew strong double digits last year and is coming online as well as Affirm, which is a split-pay option. So, we really have the chance to leverage those new tools to make our lending stronger.

And then the fourth one is we have a servicer now, Genesis, who's really helping to manage all the operations of this portfolio. So, we're really only the underwriter now for that small part of the portfolio, not the full operator of the entire thing.

Ike Boruchow
Analyst, Wells Fargo Securities LLC

Q

Thanks, Joan and Gina. That's helpful.

Operator: Thank you. And that was the last question. I would like to turn the floor to management for any closing comments.

Virginia C. Drosos
Chief Executive Officer & Director, Signet Jewelers Ltd.

Great. Well, thank you, everyone, for joining us this morning. I know it's been a crazy few months for all of us. But at Signet, we are inspired by our employees' creativity and our customers' resilience. We're energized about the opportunities we have ahead of us, and we look forward to updating you throughout the year as we continue on our Path to Brilliance transformation journey. Thanks very much.

Operator: Thank you. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.