

UK Operating review

Overview

Signet's UK division is the largest speciality retailer of fine jewellery in the UK, with 606 stores and a market share of approximately 17%. It operates as H.Samuel (18% of Group sales), targeting the middle mass market, and Ernest Jones (11% of Group sales), which is positioned at the upper end of the mass market. The division's sales during 2001/02 were £452.1 million (2000/01: £409.2 million). At 2 February 2002 the division operated 422 H.Samuel stores and 184 Ernest Jones stores (including 21 Leslie Davis stores). The stores are predominantly situated in prime "High Street" (main shopping streets with high pedestrian traffic) or shopping mall locations. H.Samuel is the largest chain of speciality retail jewellers in the UK and its stores are located in virtually every medium and large retail centre. Ernest Jones is represented in most large retail centres and is the second largest speciality retail jewellery chain in the UK.

There is a dedicated store operations management team for each of the H.Samuel and Ernest Jones chains to support and manage their development.

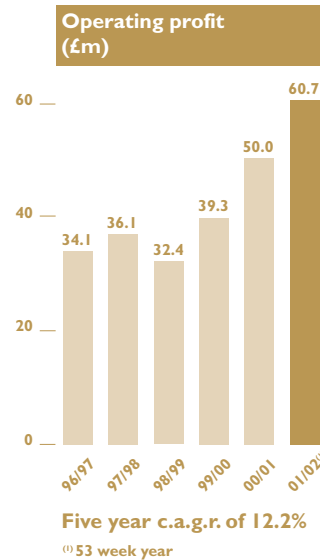
Competitive advantages

Signet believes that the division's competitive advantages comprise: the quality of its management and their experience in merchandising, marketing and store operations; the strong and long established brand names, H.Samuel and Ernest Jones; the national coverage of the chains and their complementary socio-demographic coverage; the prime locations of stores; a high level of operating standards; and economies of scale in buying and marketing and in central administration.

The UK business also enjoys a unique competitive advantage due to its close relationship with Signet's US operations. Synergies are gained by sharing merchandising knowledge and trend information, best practice systems and procedures.

Key features during 2001/02

The UK division had an excellent year with operating profit up by 21.4% at £60.7 million (2000/01: £50.0 million). Like for like sales rose by 9.4%.



Product range improvements, increased marketing activity, enhanced staff incentives and a stepped-up programme of store refurbishments, along with a favourable market for jewellery, contributed to the good performance in 2001/02. It remains the division's strategy to increase its focus on diamonds in order to increase sales in this category. As part of the ongoing programme to enhance the performance of the store portfolio some 93 stores were refitted or relocated during the year, compared with 24 the previous year. Significant increases in store refurbishments, new store openings, increased maintenance programmes and improved store layout all contributed to a better store environment.

Market place

As in the US, jewellery is sold in the UK through various distribution channels, including speciality jewellery retail stores such as those operated by the UK division. Non-speciality jewellery retailers include catalogue showrooms, jewellery departments in department stores and mail order catalogues. Reliable figures on the size of the UK jewellery market are difficult to obtain. Management believes that in calendar year 2001 the size of the total UK market for fine jewellery, costume jewellery and watches was approximately £3.2 billion (\$4.6 billion) (including VAT of 17.5%).

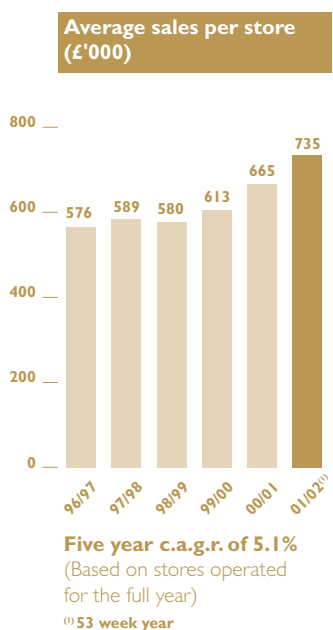
UK Operating review continued

The UK retail jewellery industry is very fragmented and competitive, with a substantial number of independent speciality jewellery retailers. The division believes there are in total approximately 7,000 speciality jewellery stores in the UK. Only three other speciality retailers of fine jewellery have more than 50 outlets.

In the middle mass market H.Samuel competes with a very limited number of other multiple speciality jewellers, including F Hinds, and a large number of independent jewellers. H.Samuel's competition at the lower end of its product range also comes from catalogue showroom outlets such as Argos and Index, and discount jewellery retailers such as Warren James.

In the upper mass market Ernest Jones faces competition from independent speciality retailers and a limited number of other upper mass market chains such as Goldsmiths Group, Beaverbrooks and Mappin & Webb/Watches of Switzerland.

Customers are attracted to H.Samuel and Ernest Jones stores because they are perceived to be friendly, unintimidating and relaxed whilst delivering expert service. With their strong brand names they offer integrity and a wide product selection in a category in which purchases are relatively infrequent. The strong performance in the UK over the past six years is illustrated in the following chart:



Store profile

The UK division believes that the location of its stores and the quality of store personnel are central to its success. H.Samuel and Ernest Jones are predominantly situated in highly visible High Street or mall locations. They employ extensive window displays that are divided into separate sections so that each product category can be easily recognised and selections made. This display method reflects the traditional preference of many UK consumers, and is in contrast to the US where many jewellery stores have display cabinets on the frontage with the mall. The division continues to test and review new store layouts and new merchandising concepts.

Details of recent investment in the store portfolio are set out below:

	Number of stores		
	2001/02	2000/01	1999/00
Store modernisations and relocations	93	24	53
New H.Samuel stores	10	9	7
New Ernest Jones stores	9	3	4
Fixed capital expenditure	£15m	£6m	£7m

H.Samuel

H.Samuel offers a wide range of jewellery, watches and gifts (see page 18 for merchandising mix). H.Samuel, in contrast to Ernest Jones, is a high volume business with a relatively low transaction value reflecting a lower proportion of diamond jewellery and a higher proportion of gifts in its sales mix. At 2 February 2002 the chain consisted of 422 stores, with an average selling space of 1,127 square feet per store. Whilst H.Samuel continues to open new stores, the opportunity to increase the total number is limited, given the chain's current nationwide coverage and policy of closing underperforming stores in order to strengthen the quality of the store portfolio.

H.Samuel store data

	2001/02	2000/01	1999/00
Number of stores			
Opened during year	10	9	7
Closed during year	(16)	(8)	(6)
Open at end of year	422	428	427
Percentage increase in like for like sales	6.4%	6.0%	2.1%
Average retail price of items sold ⁽¹⁾	£31	£28	£26
Average sales per store in thousands (exc. VAT) ⁽²⁾	£667	£609	£576

(1) Excluding accessories, repairs and warranties.

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

Ernest Jones (including Leslie Davis)

Ernest Jones' principal product categories are diamonds, gold jewellery and branded watches, all of which are merchandised and marketed to appeal to the more affluent middle market customer (see page 18 for merchandising mix). Ernest Jones sells a wide range of watches including Rotary, Seiko and Tissot as well as prestige watches such as Rolex, Cartier, Gucci, Raymond Weil, Tag Heuer, Omega, Rado and Corum. It also retails contemporary fashion watches such as Emporio Armani, Hugo Boss, DKNY and Calvin Klein. At 2 February 2002 the chain consisted of 184 stores with an average selling space of 857 square feet per store. Management considers that there is potential to increase the number of Ernest Jones stores to approximately 220.

Ernest Jones store data⁽¹⁾

	2001/02	2000/01	1999/00
Number of stores			
Opened during year	9	3	4
Closed during year	(2)	(5)	(5)
Open at end of year	184	177	179
Percentage increase in like for like sales	14.6%	13.5%	11.0%
Average retail price of items sold ⁽²⁾	£119	£109	£109
Average sales per store in thousands (exc. VAT) ⁽³⁾	£919	£805	£702

(1) Including Leslie Davis stores.

(2) Excluding accessories, repairs and warranties.

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

In the larger metropolitan markets, where market size permits, the Ernest Jones chain follows a two-site strategy, using the trade names Ernest Jones and Leslie Davis.

Store management, personnel, training and incentives

The UK division believes that customer service is one of the essential elements in the success of its business. Training programmes and enhanced incentives have contributed to the continuous improvement of the quality and performance of the staff, which has helped to drive sales. During 2001/02 the programme to upgrade store standards and customer service also continued.

The division routinely reviews activities and procedures in its stores to identify opportunities to improve customer service and to reduce the level of administration required of store staff. Sales floor and back office administrative functions were further simplified and standardised throughout the business in 2001/02. "Model stores" were identified to use as benchmarks for monitoring, reviewing and testing operating procedures to increase staff productivity in stores throughout the chain.

All new store personnel have to complete a "selling skills" learning programme during their probationary period. Sales personnel undertake further training in selling, product knowledge and customer care. Store managers undergo sales and store management training. In addition personnel are encouraged to pursue further education through courses such as the National Association of Goldsmiths' "Jewellers Training Programme", a two year course leading to certification by examination. Field and human resources management play an active role in the recruitment, performance review, training and development of sales personnel thereby ensuring consistency in operating standards and procedures throughout the UK business.

The preferred policy of the business is to promote store managers from within the division. At any given time each chain has a number of sales personnel who are able to advance to store manager level, thus assuring the availability of newly trained managers familiar with operating standards and procedures. Various incentive schemes are operated to motivate and reward performance in the stores. The bonus system is clearly focused on key controllable performance targets for store managers and area managers. It is intended that the proportion of performance related payments should increase over time.

UK Operating review continued

Merchandising and purchasing

The division retails an extensive range of merchandise including gold rings, earrings, chains and bracelets, diamond and gem set jewellery, watches, silver jewellery, silverplate, crystal and other giftware. Consistent with other UK speciality retail jewellers, most gold jewellery carried is 9 carat, although sales of 18 carat gold and platinum jewellery have been increasing in line with the demand for aspirational products.

The merchandising mix of H.Samuel and Ernest Jones, and the UK division as a whole, is given below. In the UK there is a continued consumer trend toward aspirational products such as diamond jewellery and luxury and fashion watches. Together, H.Samuel and Ernest Jones are well positioned across the mass market to benefit from this trend. In 2001/02 diamonds, fashion watches and luxury brands sold very well, whilst gold merchandise was strong in H.Samuel.

Flexible window displays enable each branch to receive and display a range of merchandise that reflects local seasonal buying patterns. Store staff receive ongoing training in product knowledge. Display equipment and layouts are

Merchandising mix

	Percentage of net sales		
	2001/02	2000/01	1999/00
	%	%	%
Gold and silver jewellery			
H.Samuel	36	35	34
Ernest Jones	27	28	28
UK division	33	32	32
Watches			
H.Samuel	24	24	25
Ernest Jones	34	33	30
UK division	28	27	27
Diamond jewellery			
H.Samuel	17	17	15
Ernest Jones	33	30	29
UK division	23	22	20
Gifts			
H.Samuel	15	16	16
Ernest Jones	3	5	5
UK division	10	12	13
Repairs and accessories			
H.Samuel	8	8	10
Ernest Jones	3	4	8
UK division	6	7	8
	100	100	100

constantly reviewed and updated to allow stores to meet the particular needs of the customer.

The majority of merchandise is purchased from a range of suppliers and manufacturers. In 2001/02, the four largest of them (all watch suppliers) together accounted for approximately 14% of the total purchases of the UK division, with the largest supplier accounting for approximately 4%. Only a small percentage of merchandise is purchased on consignment (see note 12 on page 63).

Economies of scale are achieved in combining the volume of purchases for H.Samuel and Ernest Jones. For example, some 27% of the division's gold jewellery was manufactured on a contract basis in Italy through a buying office in Vicenza, thus eliminating the costs associated with intermediaries. The division also purchases diamonds on the world markets, which are then set into castings by manufacturers in the UK, thereby providing cost savings; this accounts for about 34% of the diamond merchandise sold. Both the H.Samuel and Ernest Jones buying departments employ experienced buyers who concentrate on product development, sourcing and supplier management appropriate to their particular needs. Merchandising teams working alongside the buyers focus on assortment planning, branch grading, repeat orders, inventory levels and margin management.

Product category reviews are regularly carried out with a focus on potential gross margin return. Strict test marketing procedures are used to trial products, and their subsequent distribution is only made against tested rates of sale.

Steps have been taken to strengthen the merchandising and purchasing functions, especially for diamonds. Senior management changes have been made to raise the level of expertise and to allow greater co-ordination between the buying and merchandising functions of H.Samuel and Ernest Jones. The diamond ranges have been rationalised with greater focus on key items, and offer a wider choice in the key categories whilst reducing peripheral merchandising. Diamonds accounted for 23% of sales in 2001/02 compared with 22% in 2000/01 and 20% in 1999/00.

Marketing and advertising

Gross expenditure on marketing and advertising amounted to 2.1% of sales in 2001/02 (2000/01: 1.9% and 1999/00: 1.7%). Further initiatives to leverage the robust market

positioning and quality brand names of H.Samuel and Ernest Jones were undertaken. Marketing campaigns have been tailored to develop the distinct brand identities of H.Samuel as a middle-market jewellery and gift chain and Ernest Jones as a more upmarket diamond and watch specialist. Both campaigns aim to expand the overall customer base and improve customer loyalty.

The primary marketing and advertising medium employed in 2001/02 was a series of catalogues for each brand distributed as inserts in newspapers and magazines, and also available in the stores. During 2001/02 an Ernest Jones catalogue with a strong focus on diamonds and branded watches was developed to reflect the favourable trend toward aspirational products. An extra edition of an Ernest Jones catalogue was produced during the Christmas trading period, and the quantity of both the Ernest Jones and H.Samuel catalogues was significantly increased and their distribution better targeted.

Public relations support was stepped up for both brands, giving greater coverage in national and consumer lifestyle media titles. Increased targeted marketing activity supported key special promotional events such as design days at Ernest Jones and collectors' events at H.Samuel.

During 2001/02 H.Samuel and Ernest Jones continued to develop and improve their marketing, promotional and informational web sites on the Internet (*www.hsamuel.co.uk* and *www.ernestjones.co.uk*). Both sites have seen a substantial increase in visitor numbers and visitor time on line due to the enhanced web site design and content. The sites continue to enable management to improve its understanding of how customers use the Internet and to remain abreast of e-commerce developments.

Insurance loss replacement business

Management believes that in the UK it is the leading jewellery retailer in the insurance loss replacement business, which involves the settlement of insurance claims by product replacement through jewellery stores rather than by cash settlements from the insurance company. Given its nationwide store portfolio, breadth of product range and ability to invest in systems to support the business, the division is well positioned to benefit from insurance companies increasingly settling claims in this manner. Additional benefit

should also accrue from the higher customer traffic in stores, and the opportunity to create and build relationships with new customers.

Insurance loss replacement business placed with the division has grown significantly in recent years. In 2001/02 further investment was made to improve efficiency and customer service in the in-house telephone call centre.

Credit operations

Whilst the division does not have an in-house credit operation, it does accept major credit cards, which are treated as cash transactions. These accounted for approximately 34% of net sales during 2001/02 (2000/01: 37%). During 2001/02 approximately 2% (2000/01: 2%) of net sales in the UK were made pursuant to interest-free programmes available for purchases over a particular price. The receivables for the interest-free programmes are sold at a discount on a limited recourse basis and administered by an unaffiliated company.

Management tools and communications

The administration centre at Colindale in North London is the head office for UK store operations. It also houses the UK division's core finance, human resources, information technology, payroll, and buying and merchandising functions. The distribution facility, insurance replacement business, call centre, the customer services facility and some finance and information technology operations are located in Birmingham.

Retail management systems are in place to cover areas of inventory planning and control, purchase order management, merchandising, replenishment and distribution. The systems are package-based and allow management to track performance against budget and forecast for sales, gross margin and inventory by merchandise category and at individual store level.

The UK division's personal computer based EPOS system allows ongoing improvements in such areas as store e-mail, access to store operations and display manuals, automation and simplification of back office functions and labour scheduling in key branches. It is expected that these improvements, which will take a number of years to implement fully, will increase the time available to sales staff

UK Operating review continued

to concentrate on selling and customer service. EPOS upgrades during 2001/02 included a new “repair sales tracking” facility to assist inventory control, improve store staff productivity and enhance repair margins. A “special order” facility upgrade that allows for faster ordering and delivery of customer requested merchandise was implemented.

Systems are in place to collect data overnight from the EPOS terminals. This enables replacement, within 24 hours, of any merchandise sold in the UK stores.

The warehouse management team was reorganised and strengthened during 2001/02. Additional focus was placed on supplier compliance and extensive training and recruitment of quality control staff, leading to overall improvements in the supply chain.

A new perpetual inventory procedure was developed and implemented during the period, with branch managers checking stock by product category in all stores. This process is supported by selected full audits carried out by the internal audit function. The business benefits of this procedure include: additional loss prevention focus placed on higher risk product categories, earlier identification of stock control

issues, enhancement of stock file accuracy, and reduction of loss of sales risk associated with stock deficiencies.

All stores receive monthly operating statements detailing financial performance against budget. The statements monitor performance in sales, store payroll expenditure and other operating expenses, allowing store and area management to concentrate on issues that directly affect store profitability.

The changes to the systems required to handle the Euro in the Republic of Ireland have been successfully undertaken. The associated systems training and implementation procedures have been monitored to be used again, if required, for the UK.

Regulation

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