

Mossberg's Investor Digest

Best Idea Profile

Signet Jewelers Limited (NYSE: SIG)

DESCRIPTION:

With 1,959 stores in the US and UK, Signet Jewelers is the world's largest (by sales) specialty jeweler. In the US (75% of sales and operating profit), the company operates 926 "every kiss begins with Kay" Jewelers stores, 171 "He went to Jared" The Galleria of Jewelry stores, and 304 regional brands. In the UK (25% of sales), the company operates H.Samuel and Ernest Jones stores and is larger than the next five UK competitors combined. Kay and H.Samuel are targeted at the middle mass market, while Jared and Ernest Jones are targeted at the upper middle market.

KEY INVESTMENT CONSIDERATIONS:

Economies of Scale allow for sustainable competitive advantage – The scale of nearly 2,000 stores gives Signet significant advantages over its smaller competitors. Besides buying power, scale gives Signet the ability to use national television marketing to drive traffic to their stores. Despite producing higher operating profits than the industry, the company historically has spent 6.5% to 7.5% of sales on marketing, versus the industry average of approximately 4%. Closest competitor, Zale (NYSE: ZLC), spends 3% to 4%. Scale also allows the company to underwrite its own US customer credit. Over 50% of SIG's US sales are from in-house credit. Keeping credit in-house (versus outsourcing), allows them to capture the margin from financing and gives them greater control in managing customers' experiences.

Sector rationalization is underway – As you might imagine, the economy has been tough on jewelry retailers. During the last year, three of the top 10 middle market brands have liquidated or gone into chapter 11. Finlay, which owns Bailey, Banks and Biddle, will exit 500+ department stores, and close 50 of their 108 specialty jewelry stores. Zale has also announced a restructuring, closing of 115 stores. Of the 25,000 stores in the US, Signet estimates that 1,800 doors, representing 5% market share in dollar terms, were closed last year, a trend that is likely to continue during 2009. Sales were down 18.5% industry wide (versus 16% decline for Signet) during the holiday period, and volatile commodity costs, gold in particular, are making it challenging to manage costs. In addition, weaker operators are causing short-term disruption with heavy discounting related to clearing inventories or liquidation. While weaker competitors are going out of business and rationalizing their store bases, Signet is outperforming and continuing to produce a profit.

Buying the best operator with the strongest balance sheet at the bottom of the cycle – Historically, Signet has produced operating margin of 12%, twice the industry average. Despite challenging economic conditions, operating margin was 6.9% during fiscal 2009, which is much better than the competition. The company also maintains one of the strongest balance sheets in the industry, with credit agreements in place until 2013 and 2018 and a debt to equity ratio of 0.35. Also, recently amended credit facilities, give SIG less restrictive loan covenants. Operating profit, a strong balance sheet and an expected \$200 million in free cash flow during the current fiscal year, support the thesis that Signet will survive the downturn. As the economy emerges from the bottom of the cycle, profitably should return to historical levels and there will be less competition.

VALUATION:

The depressed economy and weak consumer spending makes SIG a bit of a contrarian play. However, shares currently trade at 4.6x EV/ EBITDA, which is an attractive valuation for an industry leader that has consistently produced ROE in the mid to high teens. Valuation multiples should also improve as the UK-headquartered company becomes better known to U.S. investors. Just last year the company listed on NYSE and is clearly trying to gain attention among US investors.

(NYSE: SIG)

Investment Data (as of 5/11/09)

Recent Price	\$17.76
52-Week Range	5.91 - 30.64
Fiscal Year End	January
Dividend	N/A
Yield	N/A
Shares Outstanding	85.3 MM
Average Trading Volume (3 mos) (NYSE Only)	360,000
Market Capitalization	1.5 B
Cash	97 MM
Long Term Debt	568 MM
Enterprise Value (EV)	1.9 B
LT Debt/ Equity	0.35
BV/ Share	18.61
TTM Revenue	3.3 B
P/ Revenue	0.5x
TTM EPS (non-GAAP)	1.57
P/ EPS	11.2x
TTM adjusted EBITDA	337 M
EV/ TTM EBITDA	5.6x

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