Value Investing Screening Analysis

Satisfactory: With a P/E ratio of 5.0x and P/B of 0.74x, Signet is well below the value thresholds of 13.0x and 1.2x, respectively. This indicates that the stock is trading cheap and may be undervalued. In addition, Management has a history of share buybacks ($460mm in FY18; $1,000mm in FY17) and has a relatively limited use of stock options. The business model is simple, as they retail jewelry, focusing on mid-market segment. Furthermore, the stock performance has been relatively poor as the company is trading at their 52-week low while the industry has been performing quite well, indicating that SIG has been underperforming in a viable industry. SIG has a simple capital structure, free of complex instruments.

Unsatisfactory: The only two criteria SIG didn't meet was size and analyst coverage. SIG has a market cap of ~US$2.3bn which is more than our value benchmark. Furthermore, they are followed by 6 analysts, as opposed to our benchmark of 2. However, this is by no means a massive and well covered company. Overall, SIG is **potentially** undervalued and should be analyzed further.

Business Risk

Medium: Signet has high and stable margins, averaging 10.9% for the past 10 years. They also have a dominant position within the mid-market jewelry segment with a share of 14%. Though the industry is quite seasonal, 50% of SIG's sales come from the bridal category which is more stable than the rest of the market. Furthermore, their proprietary R2Net technology allows them to enhance the customer experience and capitalize on the tidal change towards e-commerce. Additionally, as mall traffic has declined, SIG has put more emphasis on off-mall retail locations. The jewelry industry is profitable and viable, though it is very fragmented with many independent retailers and a few key players. As such, successful players need to find a way to differentiate their product offering. Overall the business risk is medium; Signet has positioned themselves well in a fragmented and competitive environment, their business model mitigates specific industry risks, and they have successfully adjusted to consumer trends by focusing on e-commerce and off-mall locations.

Financial Risk

Financial Risk: After adjusting the balance sheet with operating lease, we got a target capital structure of **45.2%**. Given SIG's medium risk, SIG's target B/V is at their optimal of 30-49%, which implies a **medium** financial risk. A medium-medium risk level would imply a rating of A-BBB. Given that the calculated credit statistics were leaning towards BBB, we decided that rating would be appropriate. In addition, SIG's last 10-years Bond/EBITDA is **4.1**x, which is within the expected range for BBB rated credit.

WACC: According to Federal Reserve Yields and an BBB rating, SIG has a **Kd of 4.3%.** ERP for medium BR and medium FR is **5.0%,** which gives a **Ks of 9.3%.** Using SIG's 2018 target structure of 45.2 B/V and marginal tax rate of 22.9%, SIG's **WACC is 6.55%.**

ROIC: First stage ROIC is **10.1%.** Given that this is greater than WACC, we expect EPV to be greater than NAV.

Strategic Analysis

NAV: Based on fair value of **assets of $9,470mm**, fair value of **liabilities of $4,391mm**, and 60.5mm shares outstanding, NAV/Share is **$83.94**.

EPV: Based on zero growth FCF of **$590.3mm** and equity value of **$9014.0mm**, EPV/Share is **$116.42.** This is consistent with first ROIC. Second ROIC is **7.3%**. Since ROIC > WACC and EPV > NAV, the results are consistent.

Franchise Sustainability

Management: The new CEO is an expert in building and sustaining brands. Management is making significant moves to ensure brand stability such as: investing in data analytics, transforming their real estate portfolio to reflect a consumer shift towards off-mall locations, focusing on e-commerce platforms and expanding R2Net to enhance the consumer experience. Furthermore, they are also driving innovation in merchandise by adding exclusive branding (Disney) that helps Signet's image.

Demand Advantage: With 8 different brands spanning over 3,500 stores, Signet is well positioned to serve all customer types and adapt quickly to a change in consumer taste. For a new entrant, building a brand portfolio of this magnitude and the relationships that come with it would be extremely difficult. In addition, Signet has proprietary technology that allows it to completely customize and enhance the consumer experience, which is simply unavailable to competitors and new entrants.

Cost Advantage: Signet's strong relationships with suppliers allow them to hold virtual inventory, which significantly reduces their working capital requirements and makes the business more efficient. Furthermore, their advantage of being the largest player allows them to scale costs in a way that smaller players and new entrants simply cannot.

Probability: 70%. Management identified all the weak points and put plans to address them with initiatives to maintain/grow market share and margins.

Recommendation

Intrinsic Value: **$106.68**	Entry Price: **$71.12**	Market Price: **$38.86**	Decision: **BUY**