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Signet Jewelers: Assessing Customer Financing Risk

"I think they're heading for a cliff," said Marc Cohodes referring to his latest short-sell target, Signet Jewelers (Signet).[1] Cohodes had made a long career as a canny short seller, with successful shorts on companies from pinball manufacturers to speech-recognition software companies to subprime lenders.[2] In early 2016, he had set his sights on Signet, the parent company of jewelry brands such as Kay, Zales, and Jared. Cohodes believed that Signet had become addicted to boosting sales through a risky customer credit program and had a product portfolio consisting of low-quality jewelry—"trinkets," as he called them.[3] According to Cohodes, Signet was also masking the quality of its credit program through a practice called recency accounting, which allowed them to downplay the number of customers who were delinquent on repayment.

Signet pushed back, with CEO Mark Light decrying the "targeted attack" of Cohodes and other short sellers and affirming that its in-house customer financing program, which the company considered a major competitive advantage, followed "strict risk tolerance standards."[4,5] The company also announced strategic moves, including the potential sale of its credit portfolio and an investment by a private equity firm. Investors and analysts appeared to buy Signet's argument: its stock price had stabilized by February 2017, buoyed by bullish arguments for Signet's growth prospects and competitive advantages in a fragmented jewelry industry.[6,7]

Cohodes was undeterred. He said, "Their credit book, to me, is beyond toxic. So you have a toxic business, a toxic combination, and I don't know their way out. I do not know their way out."[8]

Signet Jewelers

Company History

Signet, initially known as Ratner Group, was founded in the U.K. in 1949 and rapidly expanded through a series of acquisitions in the 1980s and early 1990s.[9] The company rebranded as Signet in 1993 and grew throughout the 2000s both organically and through acquisitions. In 2008, the company

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redomiciled in Bermuda, keeping its headquarters in Akron, Ohio. In May 2014, Signet acquired Zale Corporation, a large competitor that owned Zales jewelry stores, for $1.4 billion.[10] By 2016, Signet was the world's largest retail jeweler, focusing on the mid-market segment of the sector. The company had a 13-14% share of the $41 billion U.S. mid-market jewelry segment. No other competitor had more than a 1% share of the segment.[11] (See **Exhibit 1** for Signet's stock price data.)

Brand Strategy

In 2016, Signet employed around 30,000 people and operated in 3,625 in-mall and off-mall stores and kiosks in the US, Canada, and the UK. Signet's goal was to be the leader in the mid-market jewelry segment wherever it operated. Mid-market jewelry purchases generally ranged from $100-$10,000. Bridal jewelry was crucial to Signet, owing to the large and stable market for jewelry pieces such as engagement rings (see **Exhibit 2** on Signet's merchandise and segment mix and **Exhibit 3** for Signet's financial statements). For Signet's three main American brands, Kay, Jared, and Zales, engagement rings between $1,000-5,000 comprised 65%, 78%, and 45% of their total stock of engagement rings, respectively.[12,13,14] Signet leveraged its large size to buy many of its goods directly from international vendors, a cost advantage not available to the myriad of small players in the jewelry sector.[15]

Signet used a multi-brand strategy to capture a greater share of the mid-market jewelry sector. The company operated its Kay and Jared stores under the umbrella of Sterling Jewelers. Kay was the largest specialty retail jewelry store brand in the U.S. based on sales. Jared operated stores at free-standing sites across the U.S. Zales operated predominantly in shopping malls, emphasizing diamond jewelry to shoppers who sought jewelry from recognizable designers and brands. Amongst its international brands, Signet owned market leaders H. Samuel and Ernest Jones in the U.K. and Peoples in Canada. Accordingly, Signet's operations were organized into five business segments: Sterling Jewelers, U.K. Jewelry, Zale Jewelry, Piercing Pagoda, and Others.[16]

Customer Finance

Customers at Kay and Jared had the opportunity to access a financing program provided directly by Signet.[17] Zales stores did not offer the finance program, although they did offer third-party financing through a Zales-branded credit card and planned to adopt the credit program over time.

Signet maintained that its financing program was integral to maintaining its competitive advantage and that no other competitor had the scale and systems necessary to manage an in-house financing program.[18] Financing programs required infrastructure to approve loans, service existing loans, and collect in instances where full repayment was not received. Such infrastructure was not cheap: based on the scale of Signet operations, equity research analysts estimated that the SG&A expenses associated with retail financing businesses could total up to 30% of interest income.[19]

The financing program allowed Signet to reach middle income customers that didn't have the financial ability to purchase a piece of jewelry outright. This was a boon to bridal jewelry sales, as 75% of these sales in the Sterling division utilized financing.[20] In its 2016 annual report, Signet stated,

> Our in-house consumer financing program provides Signet with a competitive advantage through the enabling of incremental profitable sales that would not occur without a consumer financing program. Several factors inherent in the U.S. jewelry business support the circumstances through which Signet is uniquely positioned to generate profitable incremental business through its consumer financing program. These factors include a high average transaction value; a significant population of customers

seeking to finance merchandise primarily in the bridal category; and the minimum scale necessary to administer credit programs efficiently.[21]

Signet claimed that the "lifetime value" of a customer obtained through the financing program was "estimated to be 3.5 times that" of customers not obtained through the program. Higher average value for in-house financed transactions and high demand for financing in the bridal category drove this additional value. Customer financing also provided the opportunity to generate new revenues from finance charges and fees. On average, Signet's receivable portfolio turned over every nine months. At the end of January 2016 and 2015, 52.7% and 50.5% of balances due, respectively, were from customers who had enrolled in the financing program more than 12 months prior to their most recent purchase.[22] (See **Exhibit 4** on Signet's customers financing statistics.)

Credit applications originating at Signet's retail locations were automatically approved or denied by a statistical model designed by Signet's Risk Management team. The algorithm, which took the approval decision out of the hands of commissions-based salespeople, considered credit bureau information, income, employment, address verification, and debt levels.[23] Signet also relied on the Fair Isaac Corporation (FICO) score, a credit risk metric that was widely used in the consumer finance industry to assess credit worthiness.[24] Signet reported that, from 2014 to 2016, the balance-weighted FICO score for customers utilizing financing was consistently around 660.[25] In 2015, individuals earning less than 50% of median family income (MFI) in the United States had an average credit score of 664, compared to 775 for individuals with an income greater than 120% of MFI.[26] Overall, the average FICO score for adult Americans in 2015 was approximately 695.[27]

Grant's Interest Rate Observer, a leading publication covering debt markets, found that the weighted FICO score of Signet customers was "marginally higher than the 640 threshold of subprime."[28] Individuals with subprime credit scores generally received worse financing terms, generally in the form of higher interest rates.[29] Credit card issuers such as JPMorgan Chase and Citigroup typically offered interest rates that ranged from 14% for good and excellent borrowers to 25% for borrowers with average or subprime credit quality.[30]

Signet reported the performance of its accounts receivable portfolio using the recency accounting method, which required that customers paid at least 75% of their due amounts to remain current (see **Exhibit 5** for Signet's recency accounting practices). This contrasted with the more conservative "contractual method", which required customers to pay 100% of the periodical obligation by the negotiated deadline to keep a loan current.[31] (See **Exhibit 6** for opinions on the use of recency and contractual accounting).

Jewelry Industry

In 2016, sales in the U.S. jewelry sector reached $61.8 billion. Diamonds accounted for 36% of sales, although their share of total sales was falling due to lower demand and lower prices. Sector sales grew 13.5% from 2011 to 2016. Sales were categorized into two groups: costume jewelry and fine jewelry. Costume jewelry was generally inexpensive and made with imitation gems, making up 83% of sales volume but only 17% of sales value. In 2016, the average price of costume jewelry was approximately $13, fine jewelry was $311, and luxury jewelry was $1,520.[32]

The average US household spent $612 per year on fine jewelry and watches. Household income was a major driver of jewelry purchasing behavior: households with annual income of over $150,000 spent an average of approximately $2,000 on jewelry per year. Individuals aged 25-34 years and 55-64 years spent a greater amount than average on jewelry. For the 25-34 age group, marriage-related purchases were the main driver, while earning power drove the trend for the 55-64 age group. The 25-34 age group spent an average of $786 on jewelry per household.[33]

Consumers seeking to buy jewelry had several choices, from specialty retail jewelers like Signet and Tiffany & Co. (Tiffany), large all-purpose retailers such as Wal-Mart and Costco, department stores such as Macy's and J.C. Penney, online from Blue Nile, and TV retailers like QVC. Specialty jewelry retailers made up 39% of sales. Online retailing was growing, accounting for a 16% of sales by 2016, facilitated by improved technology and stronger consumer confidence in ecommerce.[34]

The retail jewelry industry was highly fragmented and competitive, with around 21,000 retailers at the end of 2014.[35] Mergers and bankruptcies were common occurrences.[36] Sector specialists reported that over 200 jewelry retailers in the U.S. closed their operations in the third quarter of 2015 alone. Specialty jewelers such as Signet, Blue Nile, and Tiffany competed on brand reputation, customer service and product innovation, with competition for engagement jewelry being especially intense.[37]

Blue Nile

In 1999, Blue Nile became the first company to sell diamonds online and soon became the world largest online retailer of diamonds and fine jewelry.[38] In 2015, the company achieved net sales of $480 million and employed over 350 people. The company's goal was to "be nothing less than the preeminent destination for diamond engagement rings and fine jewelry both online and off." It advertised competitive prices and maintained low inventory since diamonds were purchased on a "just in time" basis following customers' orders. Blue Nile aimed to maintain lower overhead than traditional jewelers and pass the savings on to the customer.[39] Blue Nile was an online-only retailer until 2015, when it began testing a display case of bridal jewelry in two Nordstrom stores.[40] Shortly after, Blue Nile opened its first display-only stores, called "Webrooms," soon expanding to four different U.S. states.[41] In the "Webrooms" customers could see and touch precious stones, and receive guidance from Blue Nile consultants. However, all transactions were still completed online.

Blue Nile did not extend credit to customers, but issued a private label credit card through a sponsoring bank. The card did not have an annual fee and awarded special access to cardholder-only offers and promotions. On Blue Nile's balance sheet, trade accounts receivable were composed primarily of amounts due from financial institutions related to credit card sales.

Tiffany & Co.

Tiffany, founded in 1837, was a global specialty retailer headquartered in New York City. The company was the clear leader of a fragmented luxury jewelry sector, capturing a 14.2% market share compared to 5.8% for the next-closest competitor, Cartier.[42] Tiffany focused on maintaining its leading position in the luxury market, projecting a brand image associated with "high-quality gemstone jewelry, particularly diamond jewelry; sophisticated style and romance; excellent customer service; an elegant store and online environment; upscale store locations; "classic" product positioning; and distinctive and high-quality packaging materials (most significantly, the TIFFANY & CO. blue box)."[43] Tiffany maintained a flagship store on Fifth Avenue in New York City, which served as an attraction for international tourists and serious buyers alike.

Tiffany managed four product segments: fashion jewelry, engagement jewelry and wedding bands, statement jewelry, and non-jewelry accessories such as leather goods, timepieces, china, crystal, and fragrances.[44] The company operated 124 Tiffany & Co. stores in the Americas, 81 stores in Asia-Pacific, 56 stores in Japan, 41 stores in Europe, and five stores in the United Arab Emirates.[45] The company also sold merchandise through an ecommerce website.

Tiffany offered a "Tiffany Select Financing" program on engagement rings and watches starting at $1,000 and all other purchases starting at $2,500.[46] The receivables associated with Tiffany's credit program amounted to $71.9 million and $75.2 million in fiscal years 2016 and 2015, respectively. Tiffany reported that 97% of those receivables were current, and its allowance for estimated losses was $1.1 million on January 31, 2017 (see **Exhibits 7a-7c** for Blue Nile and Tiffany financials).

Luxury diamond jewelry was Tiffany's main revenue source, with input purchased globally and manufactured mainly in America.[47] In 2015, engagement jewelry and wedding bands made up 29% of Tiffany's global sales, with an average price of $3,300.[48] Tiffany's had an impressive legacy of jewelry design, dating back to the 19th century. The company's website touted its legacy of design leadership, claiming to have in 1886 "introduced the engagement ring as we know it today. Previously, diamond rings were set in bezels. But Mr. Tiffany's ring was designed to highlight brilliant-cut diamonds by lifting the stone off the band into the light."[49] In addition, throughout the company's history, various organizations had commissioned Tiffany's to create custom designs, such as the Lombardi Trophy for the NFL and the Great Seal of the United States, which appears on the one-dollar bill.[50]

Cohodes Takes Aim at Signet

Cohodes' Thesis

Marc Cohodes began his finance career in 1982 at Northern Trust in Chicago after completing his undergraduate education at Babson College. In 1985, he joined David Rocker (MBA '69) at his new fund, Rocker Partners, and helped it grow from $20 million in assets to $700 million by 2000.[51] By then, Cohodes had risen to general partner, specializing in short-selling.[a] He was described as a man "who knew every trick company executives used to make their operations look better than they actually were. [Cohodes] prides himself on being able to spot trouble."[52] In 2003, Cohodes gained national attention when he engaged in a long-term short-selling campaign against NovaStar Financial, a subprime lender that eventually sought Chapter 11 bankruptcy protection.[53]

Cohodes outlined his reasoning for short-selling Signet. First, according to Cohodes,

> They [Signet] don't really sell jewelry. You can't appraise this stuff. If you go to Blue Nile, Tiffany, or the HBS jewelry store, and they sell you a ring with a 2-carat diamond with G-color, VS1-clarity, you can get it appraised and insured. You are buying an asset. It's real. You may overpay, but it's worth something. You can appraise it, you can sell it. You buy a Zales, Kay, Jared's piece of jewelry, it's not worth anything. It's not real. I mean, it's real, but it's so marked up, there's no jewel or gem value to what you're buying.[54]

Cohodes believed that Signet was boosting sales by offering customers credit because of the low quality of the jewelry. He believed that 60-65% of the company's business came from lending to customers and the sale of warranty-like Extended Service Plans (ESPs).[55] Cohodes said:

> A while ago, this guy [an activist investor] showed up and encouraged Signet to use credit to boost sales. Once you use credit to boost sales, it's like being on drugs. It's very

[a] Short-selling was a bet placed on a stock that, according to the short-seller's research and belief, was overvalued. To short-sell a stock, investors borrowed a stock from someone who owned it, then sold it. If the short seller made the right prediction, the stock fell in value and the short seller bought the stock on the open market to return what they had borrowed. If the repurchase price was lower because the stock dropped, the short seller made a profit. If the price rose, the short-seller would need more money to "cover" the same number of shares and the short-seller would lose money. Jeffrey B. Little and Lucien Rhodes, *Understanding Wall Street*, New York: McGraw-Hill, 2004, p. 94.

> hard to get off. And that's where they are. Even if they try to sell their credit book: Who wants it? And how much of a haircut will they demand in order to buy it? And it's kind of like, ok, is the credit book worth 80 cents on the dollar, 60 cents on the dollar? Whatever it is, it's not worth 100. At the end of the day the credit is no good. I come for you and say you owe me money, I want the ring back, and the guy says go fish, we broke up and she took the ring. You can repo a car that has title. You can repo a house that has title. How do you have credit or anything against some ring, necklace, earrings, or whatever?[56]

The media picked up on the concerns that Cohodes and other investors had with Signet's business model. On February 15, 2016, Bloomberg News ran an article titled "Is Signet a diamond empire or finance company?" The article detailed how an aggressive credit policy had helped Signet become one of the largest jewelry companies in the U.S. but cautioned, "behind its sparkly empire lie consumer loans that bankers might consider subprime debt."[57] Analysts estimated that 35% of Signet's receivables were owed by subprime borrowers. They estimated that if Signet was to sell its credit book it would have to take a 25% to 30% discount on its subprime receivables, while the discount on prime receivables would be no greater than 5%.[58]

Use of Recency Accounting

Cohodes was particularly concerned with Signet's accounting of its receivables portfolio through the "recency" method.[59] With recency accounting, the customer might only need to pay a portion of the amount due in a period for the account to remain current. As a result, the amount of delinquent loans was understated relative to the more widely used approach, the contractual method.[60] For Cohodes, recency accounting masked the true condition of Signet's credit portfolio:

> No retailer uses recency accounting anymore. No one uses it. The question is, why do they use it and what would it look like if they account for it like other companies? And the credit trends are not going their way and that's in a boom economy. So frankly, I don't know how they can get out of this thing. I think they're heading for a cliff. The cliff is, 'we can't sell the credit book, we can't really extend more credit and our business is very credit dependent.' It's kind of like they're going to have to go off of heroin cold turkey which is going to affect their sales and earnings. Then the stock falls and debt becomes an issue.[61]

One analyst noted that, "the percentage of non-performing loans as a percentage of Signet's receivable balance has remained constant: at 3.8% in 2015; 3.7% in 2014; 3.6% in 2013; 3.7% in 2012" and that it was rare to see such limited movement in non-performing loans, suggesting that the trend may indicate the use of the recency method to produce stable numbers.[62]

In June 2016, Grant's Interest Rate Observer reported on Signet, based on Cohodes research. The Grant's report announced that "in-store credit facilitated no fewer than 61.7% of sales in the quarter ended April 30 [2016]" increasing from 52.6% in fiscal year 2007. The report also noted Cohodes research on bankruptcy filings that named Signet as a creditor. Through March of 2016, 3,274 individuals submitting for personal bankruptcy named Signet as a creditor, up from 2,663 in the fourth quarter of 2015 and 1,903 in the first quarter of 2015.[63] Following the report, Signet stock fell 6.58%, to close at $92.23 on June 2, 2016.[64]

Extended Service Plans

There were additional concerns regarding Signet's sales of extended service plans (ESPs). The ESPs functioned like a warranty and allowed consumers to access special services, such as the possibility of having a ring resized for life. ESP sales had grown in significance as a percentage of total sales from

2014 to 2016.[65] Most rings in Signet's stores were sized 7 for women and 10 for men, requiring resizing upfront for most customers. Signet sales representatives would pitch the ESP to these customers since it was only slightly more expensive than the resizing alone. Grant's Interest Rate Observer noted that ESPs were responsible for $348 million in revenue, equal to 3.5% of total revenue, in the fiscal year ending January 30, 2016.[66] Signet did not disclose the profit margin on these plans, but Grant's believed that they were a material portion of operating earnings.[67]

Cohodes was more colorful in his characterization of the ESP program: "Why you need an extended warranty on jewelry is beyond me. That's the dumbest thing I've ever seen. Oh, it includes 'free ring sizing.' Come on now."[68]

Two Recent Scandals

Compounding the criticisms of Cohodes and other short-sellers was a run of bad news for Signet. In February 2016, an arbiter ruled that a group of current and former employees could pursue their claims that Signet had discriminated against women under the Equal Pay Act. Several female workers had filed a lawsuit in 2008 alleging that Signet had paid them less and promoted them less often than their male counterparts.[69] The arbiter's decision came two years after other female employees accused CEO Mark Light and other top executives of bias and harassment.[70] In February 2017, the Washington Post reported that "roughly 250 women and men who worked at Sterling allege that female employees at the company throughout the 1990s and 2000s were routinely sexually harassed."[71] This news led to a one-day stock price decline of 12.75%.[72] Cohodes reacted to the scandal stating: "I'm not surprised. When I invest, I always look for bad management because bad people make for great shorts. They never disappoint. They not only mess up once, they do it over and over again."

In May 2016, BuzzFeed, an internet media outlet, identified a group of Kay Jewelers customers that complained about receiving defective jewels after sending them in for repairs.[73] More than 300 customers lodged complaints against Signet with the Consumer Financial Protection Bureau, lamenting that the diamonds did not sparkle as much, had imperfections, and even had different serial numbers.[74] Analysts reported that customers were taking to Kay's Facebook page to register complaints, focusing on "increased dissatisfaction among shoppers beginning in April […] reaching an average of 5.5 complaints per day."[75] Most complaints were about replaced gems, but branched out to other products, services, lost items, and bad repairs.[76]

Signet Responds

Recency Accounting

In March of 2016, Signet began to respond to concerns about its credit portfolio and recency accounting. CFO Michele Santana responded to criticisms, saying that "we [Signet] have provided and operated in-house credit for 30 years and it gives us a number of competitive advantages," especially when it came to bridal sales. She continued: "due to our scale, we are able to administer our credit program very efficiently and effectively," and that it was "designed for rapid repayment that minimizes risk and enables the customer to make additional jewelry purchases using their credit facility."[77]

During the 2016 first quarter conference call in May 2016, Santana responded to questions about the use of recency accounting:

> At the end of the day, regardless of recency or contractual, whatever method you're on, the financial results are going to yield the same answer. The provision will be the same, our bad debt expense will be the same, but to that point, the reason why we use our recency is, one, we have done it since the beginning of time and it really has worked well for us over the years with the type of lending that we do. Jewelry lending is that emotional connection and it does optimize our collections for us… It gives the customer some flexibility based on the disciplined criteria that we had outlined of our recency ageing, what a customer has to remit to stay current. It leaves that customer in good standing if they are having maybe a challenging month where they can't remit a full payment, and that psychology and that flexibility of working with that customer puts that customer first…[78]

Santana assured analysts that Signet's financial results would be the same regardless of the kind of accounting practice they used and that the range of customer FICO scores was "broadly in the same range as what we saw in [2015] Q4."[79]

Credit Portfolio Review

Signet announced in its May 2016 conference call that its board of directors had authorized management to conduct a strategic evaluation of the company's credit portfolio. Goldman Sachs had been engaged as the company's financial advisor in this process.[80] CEO Light said,

> We will consider a full range of options as we evaluate our in-house and outsourced credit programs. These options include but are not limited to optimizing credit offerings, optimizing allocated debt and equity capitalization of the credit portfolio including potential incremental securitization; bringing all credit function in-house over the long term; insourcing some credit functions and outsourcing others, and outsourcing all credit functions. This evaluation is a top priority and as we move through this we will remain focused on executing our operational plans and driving profitable growth in our business.[81]

Signet announced its second quarter fiscal year 2016 results in August 2016. Light provided an update on the sale of the credit portfolio, stating that they were moving "as quickly and prudently as possible" on the issue. He assured investors that, if the credit portfolio remained on Signet's books, they would likely "increase leverage against it and use the proceeds on growth initiatives, buybacks and/or dividends." Light also noted that Signet would "likely revamp and expand our reporting and disclosure of credit profitability, contractual aging, and other metrics."[82] Throughout, Light defended Signet's business model, saying "much like other companies that sell valuable things like cars and computers, we at Signet sell products, we finance them and we insure them. It's a complete end-to-end solution that our customers embrace and makes great business sense for us."[83]

Leonard Green & Partners Investment and Second Quarter Results

Signet's 2016 second quarter results showed a decrease in total sales of 2.6%, compared to a 4.2% increase in the same quarter in the prior year. Light admitted that "Signet sales and earnings were disappointing in the second quarter, giving no sign yet of a rebounding trend." Yet he remained optimistic: "To sum up, we had a challenging quarter but we know why and we have sound plans to address it. We possess numerous competitive advantages and expect to strengthen our leading position and gain profitable market share."[84]

During the earnings call, Light announced that the private equity firm Leonard Green & Partners had agreed to invest $625 million in convertible preferred Signet shares, representing 8% of Signet common stock. Signet intended to use most of the proceeds in a share buyback scheme.[85] Signet believed that Leonard Green & Partners would bring retail experience to the board, and added Jonathan Sokoloff of the firm to its board. Light said: "We wanted a long-term investor. A firm doing due diligence and getting under the covers validates our business model that Wall Street as a whole isn't getting."[86] Cohodes saw the investment in a different light:

> Why wouldn't you invest in the convertible preferred? They get a 5% dividend and are protected in the downside. Let's say the company hits the trees, they're first in line. First in the capital structure. All that is, is kind of a high juice loan. You do that deal all day long. What do they care? The stock could go to zero, and if the company is really in trouble, they're first in line. They're more than happy to step up.

Response to Recent Scandals

Responding to the BuzzFeed report on alleged gem swaps and jewelry quality, Signet issued a press release in June 2016, stating:

> "Signet Jewelers' entire team culture is directed toward ensuring that we earn and maintain customer trust. […] This commitment to customer care has allowed Signet to satisfy many millions of customers, year after year. […] In our design and service centers, we manage more than 4,000,000 service and repair transactions each year, and over 99% are completed without negative customer feedback. Of those generating negative customer feedback, many are related to either repairs taking longer than expected due to our high standards, or shipping delays, which we work diligently to address in cooperation with our shipping partners. In addition, we strongly object to recent allegations on social media, republished and grossly amplified, that our team members systematically mishandle customers' jewelry repairs or engage in "diamond swapping." Incidents of misconduct, which are exceedingly rare, are dealt with swiftly and appropriately.

Light added: "The trust of our customers is not something we take lightly. It has been an honor to help our customers [...] for almost 100 years, and dedication to superior customer service and quality control is integral to who we are and how we conduct business. Our guests are our most precious commodity, and we are committed to maintaining their trust."[87] Signet announced in August that it would be testing an in-store system to "highlight the unique marks of everybody's diamond." Light maintained that Signet had "a great process in place" when it came to the careful repair and return of jewelry, but said that the new systems would create "even more transparency" and would be a "huge competitive advantage" for Signet over time.[88]

In response to the company's ongoing gender discrimination scandal, Signet issued a public response:

> The fact is, many of the allegations were brought to Sterling's attention for the first time during the current litigation, and some appear to date back more than 25 years. The company has processes in place for receiving and investigating such allegations, and we wish that anyone who had a workplace concern back then used those processes, so that we could have investigated their concerns and responded appropriately.[89]

Light also took aim at the short-sellers, claiming Signet was the victim of a "targeted attack by short sellers, who led an orchestrated campaign to amplify the controversy."[90]

Changes in ESP Accounting[91]

In May 2016, Signet changed its revenue recognition practices relating to ESPs. Prior to this date, "the Sterling Jewelers division deferred and recognized revenue of its ESPs over a period of 14 years, with approximately 45% of the revenue recognized in the first two years." With the change in revenue recognition, "the Sterling Jewelers division deferred and recognized revenue over 17 years for all ESPs." It also started including the upfront resizing costs as part of the ESPs' claim costs, changing its accounting policies to recognize "approximately 57% [of] revenue within the first two years for ESPs sold on or after May 2, 2015." Signet claimed the move was intended to bring ESP revenue recognition for the Sterling division in line with practices in the Zale division.

2016 Results

Signet published its 2016 results on March 9, 2017 and used its earnings call to directly address some of the concerns of Cohodes and the other short-sellers while reaffirming its strength in mid-market jewelry. CEO Mark Light commented

> Over the last seven years, post-recession, Signet U.S. total sales have grown at 12% compounded annual growth rate. […] Signet has consistently outperformed the jewelry industry. Given the fragmented industry, we believe we have many years of profitable growth and market share gains ahead of us.[92]

However, short-selling and the attendant public criticisms of Signet had shaken investor confidence. The stock had fallen from a peak of $151 on October 30, 2015 to $70 on March 9th, 2017.[93]

Sell-Side Analyst Reaction

Prior to Cohodes' involvement, analyst sentiment was predominantly bullish heading into 2016. The bullish tone was kicked off by the well-known analyst Abby Joseph Cohen, president of the Global Markets Institute at Goldman Sachs, who picked Signet as one of her stocks to watch at Barron's 2016 Investment Roundtable in January 2016 when the stock was trading at $126.93. Cohen said that "The company has had some issues: It was sued for gender discrimination. But Signet is held in high esteem by customers, and has a good distribution network."[94]

Other analysts did not share Cohodes's concerns about Signet's credit portfolio. Analysts at Wells Fargo's Equity Research believed the risk was overstated, noting on June 23, 2016 that 65% of all transactions across all of Signet's businesses had been made without credit since mid-2015. The analysts were also unconcerned with the use of recency accounting, reporting that Signet's percentage of non-performing loans peaked at 5% during the 2008-2009 credit crisis, compared to 4% at the time of the report, and that the company had nonetheless emerged from the recession "relatively healthy." Finally, the analysts noted that the number of credit accounts per Kay/Jared store had been roughly steady over five years, which they took as evidence that Signet had not "been moving down the credit chain to a broader set of customers."[95]

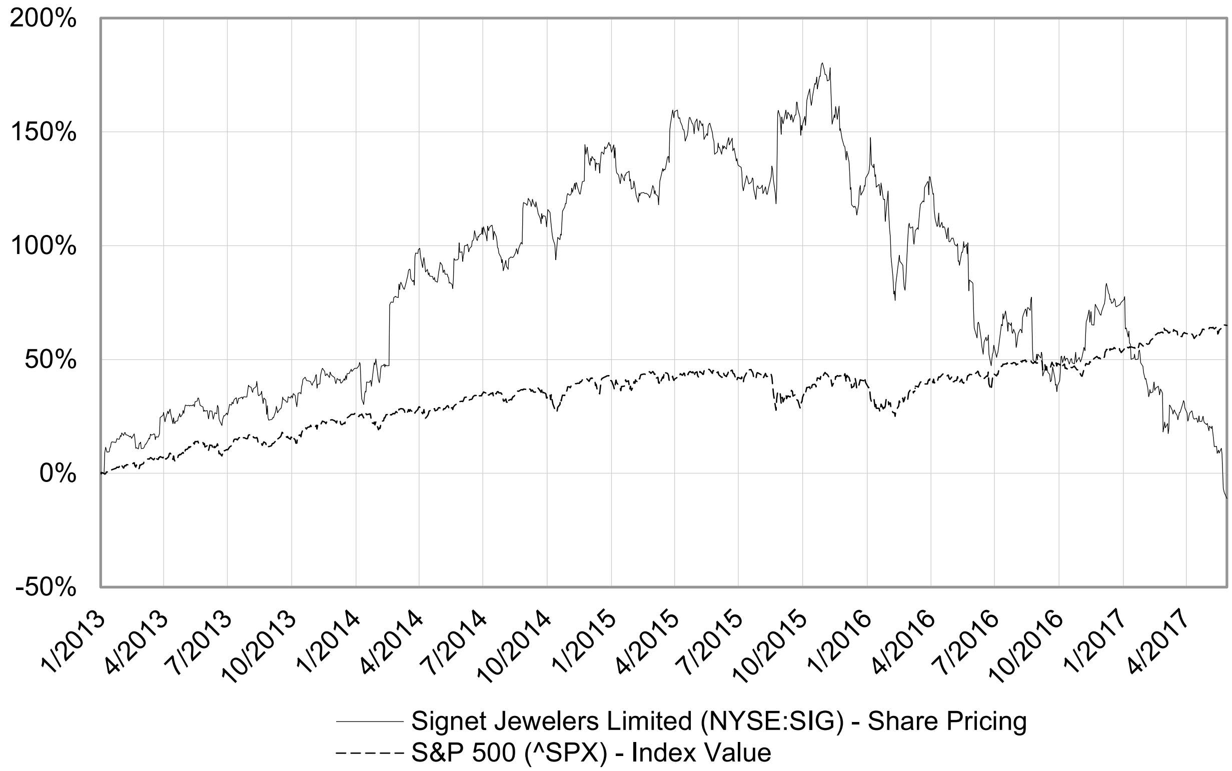
Deutsche Bank Market Research remained positive on Signet and gave it a "buy" rating in its August 2016 report. They believed that Signet's business had been hurt by the BuzzFeed report and the attacks on its credit portfolio by short-sellers, but did not believe that these issues would do any more than cause some short-term volatility. Deutsche Bank's analysts encouraged Signet to look past the scandals of the past couple of months and to instead focus on the strength of its product line going into the 2016 holiday season. Additionally, they believed that any downside associated with the sale of Signet's credit book would be offset by management's stated commitment to creating shareholder value through the sale of the book.[96]

Other analysts were more bearish and offered caveats. J.P. Morgan Equity Research downgraded Signet to "neutral," stating that it believed that Signet could achieve earnings growth in the low double digits over the next couple of years despite concerns about the macro environment.[97] Analysts were also predicting that Signet would forego potential revenue if the sale of its $1.7 billion credit portfolio was successful. Wells Fargo anticipated a potential sale price of $1.5 billion and a profit-sharing arrangement.[98] However, $600 million of the proceeds would have to be used to repay a securitization backed by accounts receivables. In addition, they also forecasted $800-850 million in lost revenues due to the lost control of the credit operation. Ultimately, according to the Wells Fargo analysts, in selling the credit business, Signet would put at risk a financial tool that was responsible for 15-20% of annual earnings per share (EPS).[99]

Looking Ahead

As Cohodes analyzed the last set of financials released by Signet on March 9th, 2017, he evaluated his position on the company. Analyst sentiment was positive, but Signet did not appear any closer to selling its credit book and it had done little to change its credit-dependent business model. This reinforced Cohodes' belief that all was not well with Signet's credit book and that analyst optimism was "influenced by the investors holding the stock, and [sell-side analysts] were always late to see problems within the companies they followed." He evaluated how the risks in Signet's business model were reflected in the company's financials and how the company's recent actions affected his thesis.

Exhibit 1 Signet Stock Price (NYSE: SIG), January 2013-March 2017 ($ unit)



Source: Capital IQ, accessed May 2017.

Exhibit 2 Signet Merchandise and Segment Mix

Fiscal Year Ending 1/28/2017	Sterling Jewelers division	Zale division	UK Jewelry division	Other	Total Signet
Diamonds and diamond jewelry	77%	60%	35%		68%
Gold and silver jewelry, including charm bracelets	9%	28%	17%		15%
Other jewelry, including gift category	8%	9%	16%		9%
Watches	6%	3%	32%		8%
	100%	100%	100%		100%
Sales ($ Millions)	**3,930.4**	**1,812.8**	**647.1**	**18.1**	**6,408.4**
	61.3%	28.3%	10.1%	0.3%	100.0%

Source: Compiled from financial information in Signet's 2017 Annual Report.

Exhibit 3a Signet Jewelers Income Statements, 2013-2017 ($ Millions)

Fiscal Year	2012	2013	2014	2015	2016
Revenue	3,983.4	4,209.2	5,736.3	6,550.2	6,408.4
Cost Of Goods Sold	(2,446.0)	(2,628.7)	(3,662.1)	(4,109.8)	(4,047.6)
Gross Profit	**1,537.4**	**1,580.5**	**2,074.2**	**2,440.4**	**2,360.8**
Selling General & Admin Exp.	(1,138.3)	(1,196.7)	(1,712.9)	(1,987.6)	(1,880.2)
Interest Income In-house Finance	159.7	186.4	217.9	252.6	282.5
Other Operating Income (Expense)	1.7	0.3	(2.6)	(1.7)	0.1
Operating Income	**560.5**	**570.5**	**576.6**	**703.7**	**763.2**
Interest Expense	(3.6)	(4.0)	(36.0)	(45.9)	(49.4)
EBT	**556.9**	**566.5**	**540.6**	**657.8**	**713.8**
Income Tax Expense	(197.0)	(198.5)	(159.3)	(189.9)	(170.6)
Net Income	**359.9**	**368.0**	**381.3**	**467.9**	**543.2**

Source: Signet's Annual Reports.

Note: Signet's fiscal year ended on the fourth Saturday of the following year. Fiscal year ending dates for the five years listed are as follows: 2/2/2013, 2/1/2014, 1/31/2015, 1/30/2016, and 1/28/2017.

Exhibit 3b Signet Jewelers Balance Sheet, 2013-2017 ($ Millions)

Fiscal Year	2012	2013	2014	2015	2016
ASSETS					
Cash And Equivalents	301.0	247.6	193.6	137.7	98.7
Accounts Receivable, Gross	1,293.0	1,471.8	1,680.7	1,886.4	1,996.7
Bad Debt Allowance	(87.7)	(97.8)	(113.1)	(130.0)	(138.7)
Accounts Receivable, Net	1,205.3	1,374.0	1,567.6	1,756.4	1,858.0
Other Receivables	42.1	51.5	63.3	84.0	95.9
Inventory	1,397.0	1,488.0	2,439.0	2,453.9	2,449.3
Other Current Assets	90.7	96.5	139.3	156.1	140.7
Total Current Assets	**3,036.1**	**3,257.6**	**4,402.8**	**4,588.1**	**4,642.6**
Gross Property, Plant & Equipment	1,154.5	1,275.7	1,518.0	1,676.8	1,872.3
Accumulated Depreciation	(724.1)	(788.1)	(852.1)	(949.2)	(1,049.4)
Net Property, Plant & Equipment	**430.4**	**487.6**	**665.9**	**727.6**	**822.9**
Goodwill	24.6	26.8	519.2	515.5	517.6
Intangible Assets, net	-	-	447.1	427.8	417.0
Deferred Tax Assets, LT	104.1	113.7	2.3	-	0.7
Retirement benefit asset	48.5	56.3	37.0	51.3	31.9
Other Long-Term Assets	75.3	87.2	140.0	154.6	165.1
Total Assets	**3,719.0**	**4,029.2**	**6,214.3**	**6,464.9**	**6,597.8**
LIABILITIES					
Accounts Payable	155.9	162.9	277.7	269.1	255.7
Accrued Expenses and Other	326.4	328.5	482.4	498.3	478.2
Loans and overdrafts	-	19.3	97.5	57.7	91.1
Curr. Income Taxes Payable	100.3	103.9	86.9	65.7	101.8
Unearned Revenue, Current	159.7	173.0	248.0	260.3	276.9
Def. Tax Liability, Curr.	129.6	113.1	-	-	-
Total Current Liabilities	**871.9**	**900.7**	**1,192.5**	**1,151.1**	**1,203.7**
Long-Term Debt	-	-	1,363.8	1,321.0	1,317.9
Unearned Revenue, Non-Current	405.9	443.7	563.9	629.1	659.0
Def. Tax Liability, Non-Curr.	-	-	53.5	72.5	101.4
Other Non-Current Liabilities	111.3	121.7	230.2	230.5	213.7
Total Liabilities	**1,389.1**	**1,466.1**	**3,403.9**	**3,404.2**	**3,495.7**
Pref. Stock, Convertible	-	-	-	-	611.9
Total Pref. Equity	**-**	**-**	**-**	**-**	**611.9**
Common Stock	15.7	15.7	15.7	15.7	15.7
Additional Paid In Capital	246.3	258.8	265.2	279.9	280.7
Retained Earnings	2,268.4	2,812.9	3,135.7	3,534.6	3,995.9
Treasury Stock	(260.0)	(346.2)	(370.0)	(495.8)	(1,494.8)
Comprehensive Inc. and Other	59.5	(178.1)	(236.6)	(273.7)	(307.3)
Total Common Equity	**2,329.9**	**2,563.1**	**2,810.4**	**3,060.7**	**2,490.2**
Total Equity	**2,329.9**	**2,563.1**	**2,810.4**	**3,060.7**	**3,102.1**
Total Liabilities And Equity	**3,719.0**	**4,029.2**	**6,214.3**	**6,464.9**	**6,597.8**

Source: Compiled from Signet's Annual Reports.

Note: Signet's fiscal year ended on the fourth Saturday of the following year. Fiscal year ending dates for the five years listed are as follows: 2/2/2013, 2/1/2014, 1/31/2015, 1/30/2016, and 1/28/2017.

Exhibit 3c Signet Cash Flow, 2013-2017 ($ Millions)

Fiscal Year	2012	2013	2014	2015	2016
Net Income	**359.9**	**368.0**	**381.3**	**467.9**	**543.2**
Depreciation & Amort.	99.4	110.2	139.3	160.7	173.7
Amort. of Goodwill and Intangibles	-	-	(14.1)	(14.8)	(5.9)
Depreciation & Amort., Total	**99.4**	**110.2**	**125.2**	**145.9**	**167.8**
Other Amortization	0.4	0.4	7.4	3.6	2.8
Asset Writedown & Restructuring Costs	-	-	0.8	0.7	1.3
Stock-Based Compensation	15.7	14.4	12.1	16.4	8.0
Tax Benefit from Stock Options	(7.4)	(6.5)	(11.8)	(6.9)	(2.4)
Other Operating Activities	(7.6)	(29.1)	(51.5)	26.1	23.2
Change in Short-Term Receivables	(117.1)	(168.7)	(193.6)	(188.8)	(101.6)
Change In Inventories	(65.7)	(98.4)	(121.6)	(46.0)	(9.7)
Change in Acc. Payable	(39.6)	3.2	23.7	(6.4)	(7.0)
Change in Unearned Rev.	40.6	50.8	102.3	76.3	43.6
Change in Inc. Taxes	27.2	7.9	(1.6)	(25.7)	38.9
Change in Other Net Operating Assets	6.9	(16.7)	10.3	(19.8)	(29.8)
Cash from Ops.	**312.7**	**235.5**	**283.0**	**443.3**	**678.3**
Capital Expenditure	(134.2)	(152.7)	(220.2)	(226.5)	(278.0)
Cash Acquisitions	(56.7)	(7.7)	(1,429.2)	-	-
Invest. in Marketable & Equity Secur.	-	-	(3.2)	(2.2)	(0.4)
Cash from Investing	**(190.9)**	**(160.4)**	**(1,652.6)**	**(228.7)**	**(278.4)**
Short Term Debt Issued	-	76.3	39.4	-	-
Long-Term Debt Issued	-	-	3,000.3	2,619.9	3,674.1
Total Debt Issued	**-**	**76.3**	**3,039.7**	**2,619.9**	**3,674.1**
Short Term Debt Repaid	-	(57.0)	-	(47.1)	(10.2)
Long-Term Debt Repaid	-	-	(1,612.7)	(2,645.9)	(3,634.7)
Total Debt Repaid	**-**	**(57.0)**	**(1,612.7)**	**(2,693.0)**	**(3,644.9)**
Issuance of Common Stock	21.6	9.3	6.1	5.0	2.1
Repurchase of Common Stock	(287.2)	(104.7)	(29.8)	(130.0)	(1,000.0)
Issuance of Pref. Stock	-	-	-	-	611.3
Common Dividends Paid	(38.4)	(46.0)	(55.3)	(67.1)	(75.6)
Total Dividends Paid	**(38.4)**	**(46.0)**	**(55.3)**	**(67.1)**	**(75.6)**
Other Financing Activities	(4.1)	(2.7)	(27.1)	(1.4)	(5.2)
Cash from Financing	**(308.1)**	**(124.8)**	**1,320.9**	**(266.6)**	**(438.2)**
Foreign Exchange Rate Adj.	0.5	(3.7)	(5.3)	(3.9)	(0.7)
Net Change in Cash	**(185.8)**	**(53.4)**	**(54.0)**	**(55.9)**	**(39.0)**

Source: Compiled from Signet's Annual Reports.

Note: Signet's fiscal year ended on the fourth Saturday of the following year. Fiscal year ending dates for the five years listed are as follows: 2/2/2013, 2/1/2014, 1/31/2015, 1/30/2016, and 1/28/2017.

Exhibit 4a Sterling Jewelers—Customer Financing Statistics

Fiscal Year	2012	2013	2014	2015	2016
Total sales (millions)	3,273.9	3,517.6	3,765.0	3,988.7	3,930.4
Credit sales (millions)	1,862.9	2,028.0	2,277.1	2,451.2	2,438.3
Credit sales as % of total Sterling Jewelers sales (1)	56.9%	57.7%	60.5%	61.5%	62.0%
Net bad debt expense (millions)	122.4	138.3	160.0	190.5	212.1
Net bad debt as a % of Sterling Jewelers credit sales	6.6%	6.8%	7.0%	7.8%	8.7%
Number of active credit accounts at year end (2)	1,173,053	1,256,003	1,352,298	1,423,619	1,401,456
Average outstanding account balance at year end	1,110.0	1,175.0	1,245.0	1,319.0	1,405.0
Average monthly collection rate	12.4%	12.1%	11.9%	11.5%	11.0%
Ending bad debt allowance as a % of ending gross accounts receivable	6.8%	6.7%	6.8%	7.0%	7.1%
Net write-offs as a % of average gross accounts receivable	9.2%	9.4%	9.3%	9.9%	10.7%
Credit portfolio impact					
Net bad debt expense (millions)	(122.4)	(138.3)	(160.0)	(190.5)	(212.1)
Late charge income (millions)	27.5	29.4	31.3	33.9	36.0
Interest income from in-house customer finance programs (millions)	159.7	186.4	217.9	252.5	277.6
	64.8	**77.5**	**89.2**	**95.9**	**101.5**

Source: Compiled from Signet's Annual Reports.

Notes: (1) Including any deposits taken at the time of sale.

(2) The number of active accounts is based on credit cycle end date closest to the fiscal year end date.

Exhibit 4b Sterling Jewelers In-House Finance Receivables ($ Millions)

Fiscal Year	2012	2013	2014	2015	2016
Sterling Jewelers in-house receivables and bad debt allowance					
Bad Debt Allowance					
Beginning balance:	(78.1)	(87.7)	(97.8)	(113.1)	(130.0)
Write-offs, net	112.8	128.2	144.7	173.6	203.4
Net bad debt expense	(122.4)	(138.3)	(160.0)	(190.5)	(212.1)
Ending balance	(87.7)	(97.8)	(113.1)	(130.0)	(138.7)
Ending balance Accounts Receivable, gross	1,280.6	1,453.8	1,666.0	1,855.9	1,952.0
Bad Debt Allowance	(87.7)	(97.8)	(113.1)	(130.0)	(138.7)
Ending balance Accounts Receivable, net	**1,192.9**	**1,356.0**	**1,552.9**	**1,725.9**	**1,813.3**

Source: Compiled from Signet's Annual Reports.

Note: During the third quarter of Fiscal 2016, Signet implemented a program to provide in-house credit to customers in the Zale division's US locations. The resulting accounts receivable balance and allowance for doubtful accounts was immaterial as of January 28, 2017 and January 30, 2016.

Exhibit 4c Sterling Jewelers Aging of Signet's In-House Receivables

Fiscal Year	**2012**		**2013**		**2014**		**2015**		**2016**	
Credit Quality Indicator and Age Analysis:	Gross	Bad Debt Allowance	Gross	Bad Debt Allowance	Gross	Bad Debt Allowance	Gross	Bad Debt Allowance	Gross	Bad Debt Allowance
Performing ($ million):										
Current, aged 0 - 30 days	1,030.3	(33.8)	1,170.4	(36.3)	1,332.2	(41.1)	1,473.0	(45.4)	1,538.2	(47.2)
Past due, aged 31 - 90 days (2012)	203.9	(7.5)								
Past due, aged 31 - 60 days			195.7	(6.4)	230.2	(7.5)	259.6	(8.3)	282.0	(9.0)
Past due, aged 61 - 90 days			34.2	(1.6)	40.9	(1.8)	49.2	(2.2)	51.6	(2.3)
Non Performing ($ million):										
Past due, aged more than 90 days	46.4	(46.4)	53.5	(53.5)	62.7	(62.7)	74.1	(74.1)	80.2	(80.2)
Total	**1,280.6**	**(87.7)**	**1,453.8**	**(97.8)**	**1,666.0**	**(113.1)**	**1,855.9**	**(130.0)**	**1,952.0**	**(138.7)**
Performing (as a % of the ending receivable balance):										
Current, aged 0 - 30 days	80.5%	3.3%	80.5%	3.1%	80.0%	3.1%	79.4%	3.1%	78.8%	3.1%
Past due, aged 31 - 90 days (2012)	15.9%	3.7%								
Past due, aged 31 - 60 days			13.5%	3.3%	13.8%	3.3%	14.0%	3.2%	14.4%	3.2%
Past due, aged 61 - 90 days			2.3%	4.7%	2.5%	4.4%	2.7%	4.5%	2.6%	4.5%
Non Performing ($ million):										
Past due, aged more than 90 days	3.6%	100.0%	3.7%	100.0%	3.8%	100.0%	4.0%	100.0%	4.1%	100.0%
Total	**100%**	**6.8%**	**100%**	**6.7%**	**100%**	**6.8%**	**100%**	**7.0%**	**100%**	**7.1%**

Source: Compiled from Signet's Annual Reports.

Exhibit 5 Signet's In-House Recency Accounting Method

Portfolio aging

Since inception of its in-house financing, Signet measures delinquency and establishes loss allowances using a form of the recency method. This form of the recency method relies upon qualifying payments determined by management to measure delinquency. In general, an account will not remain current unless a qualifying payment is received. A customer is aged to the next delinquency level if they fail to make a qualifying payment by their monthly aging. A customer's account ages each month five days after their due date listed on their statement, allowing for a grace period before collection efforts begin. A qualifying payment can be no less than 75% of the scheduled payment, increasing with the delinquency level. If an account holder is two payments behind, then they must make a full minimum payment to return to current status. If an account holder is three payments behind, then they must make three full payments before returning to a current status. If an account holder is more than three payments behind, then the entire past due amount is required to return to a current status. Establishing qualifying payment methods in accounting for delinquencies is appropriate considering the high minimum payments that are required of customers. The weighted average minimum payment required as a percentage of the outstanding balance was 9% at year-end fiscal 2016. The minimum payment does not decline as the balance declines. These two facts combined (higher scheduled payment requirement and no decline in payment requirement as balance decreases) allow Signet to collect on the receivable significantly faster than other retail/bank card accounts, which require a 3%-5% minimum payment, reducing risk and more quickly freeing up customer open to buy for additional purchases. Of all payments received in the fiscal year, 97% were equal to or greater than the scheduled monthly payment compared to 97% last year. While guests can make payments through online or mobile channels, via telephone or through the mail, 25% of payments are made in one of our retail locations.

Allowances for uncollectible amounts are recorded as a charge to cost of goods sold in the income statement. The allowance is calculated using a model that analyzes factors such as delinquency rates and recovery rates. An allowance for amounts 90 days aged and under on a recency basis is established based on historical loss experience and payment performance information. A 100% allowance is made for any amount aged more than 90 days on a recency basis and any amount associated with an account the owner of which has filed for bankruptcy. An account is 90 days aged on a recency basis when there has not been a qualifying payment made within 90 days of the billing date. The net bad debt expensed on the income statement is equal to the sum of the total change in the allowance for uncollectible accounts and the total amount of written off balances less any recoveries for accounts previously written off. The allowance calculation is reviewed by management to assess whether, based on economic events, additional analysis is required to appropriately estimate losses inherent in the portfolio.

We deem accounts to be uncollectible and write off when the account is both more than 120 days aged on a recency basis and 240 days aged on a contractual basis at the end of a month. Over the last 12 months, we have recovered 18% of written-off amounts through our collection activities and the sale of previously written off accounts.

Source: Extract from Signet 2016 Annual Report.

Note: "The leverage ratio was a non-GAAP measure calculated by dividing Signet's adjusted debt by adjusted EBITDAR. Signet's adjusted debt was defined as debt recorded in the consolidated balance sheet, plus an adjustment for operating leases, less 70% of outstanding in-house finance receivables recorded in the consolidated balance sheet." Signet 2016 Annual Report.

Exhibit 6 On the Two Main Methods of Measuring the Level of Delinquency

Recency Accounting vs. Contractual Accounting

"[Recency accounting] is illegal in some jurisdictions, frowned upon in many more and universally misleading. Recency makes it next-to-impossible to calculate the actual loss of yield, and therefore, the ultimate loss on the loan. […] There need not be any disclosure on recency methods for loans financed with in the Asset-backed commercial paper program (ABCP) conduits, where the market practice has long and successfully resisted many forms of disclosure considered the norm in term of securitizations."[1]

According to the Federal Reserve: "Bank holding companies should not change their aging methodology from contractual to recency without the prior concurrence of the Federal Reserve. A bank holding company will not be permitted to change its methodology if the intent or effect of such a change is to mask asset quality or financial weaknesses. In those cases, where a bank holding company uses the recency method, it should have adequate controls in place to accurately track the performance of loans within the retail portfolio and demonstrate sound and compelling business reasons for the use of this method." [2]

The Federal Reserve continued: "In accordance with the Call Report instructions, banks and their consumer finance subsidiaries are required to use the contractual method, which ages loans based on the status of contractual payments. In general, the contractual method provides a more accurate reflection of loan performance and, therefore, is the preferred methodology, especially from the standpoint of financial statement transparency and public disclosure."[3]

On June 16, 2016, the Financial Accounting Standards Board (FASB) issued new impairment guidance for financial instruments with impact on all reporting entities. "Generally, the initial estimate of the expected credit losses (ECL) and subsequent changes in the estimate will be reported in current earnings. The EC will be recorded through an allowance for loan and lease losses (ALLL) in the statement of financial position. The new model will apply to: 1) financial assets subject to credit losses and measured at amortized cost, and 2) certain off-balance sheet credit exposures." Early application of the guidance will be permitted for all entities for fiscal years beginning after December 15, 2018.[4]

Source: [1] Ann Rutledge and Sylvain Raynes, *Elements of Structured Finance*, Oxford University Press: Oxford, 2010, p. 86.

[2,3] Board of Governors of the Federal Reserve System, Supervisory Letter on Revised Uniform Retail Credit Classification and Account Management Policy, June 12, 2000, https://www.federalreserve.gov/boarddocs/srletters/2000/SR0008.HTM, accessed October 2016.

[4] "In brief: Allowance for loan and lease losses – FASB issues final impairment standard," PwC Web site, June 16, 2016, http://www.pwc.com/us/en/cfodirect/publications/in-brief/fasb-new-impairment-guidance-financial-instruments.html, accessed October 2016.

Exhibit 7a Income Statements for Blue Nile and Tiffany ($ Millions)

Fiscal Year	2012	2013	2014	2015	2013	2014	2015	2016
	Blue Nile				Tiffany			
Total Revenue	400.0	450.0	473.5	480.1	4,031.1	4,249.9	4,104.9	4,001.8
Cost Of Goods Sold	(325.0)	(366.4)	(386.9)	(387.7)	(1,690.7)	(1,712.7)	(1,613.6)	(1,511.5)
Gross Profit	**75.0**	**83.7**	**86.6**	**92.3**	**2,340.4**	**2,537.2**	**2,491.3**	**2,490.3**
Selling General & Admin Exp.	(62.8)	(69.3)	(72.4)	(76.3)	(1,555.9)	(1,645.8)	(1,731.2)	(1,769.1)
Operating Income	**12.3**	**14.3**	**14.2**	**16.1**	**784.5**	**891.4**	**760.1**	**721.2**
Interest Income (Expense)	0.1	0.1	0.1	0.1	(62.6)	(62.9)	(49.0)	(46.0)
Other Income (Expense), net	0.5	0.2	0.3	(0.0)	13.2	2.8	(1.2)	1.4
EBT Excl. Unusual Items	**13.0**	**14.6**	**14.6**	**16.1**	**735.1**	**831.3**	**709.9**	**702.0**
Legal Settlements	-	-	-	-	(480.2)	-	-	-
Other Unusual Items	-	-	-	-	-	(93.8)	-	-
EBT Incl. Unusual Items	**13.0**	**14.6**	**14.6**	**16.1**	**254.9**	**737.5**	**709.9**	**676.6**
Income Tax Expense	(4.6)	(3.7)	(4.9)	(5.6)	(73.5)	(253.3)	(246.0)	(230.5)
Net Income	**8.4**	**10.9**	**9.7**	**10.5**	**181.4**	**484.2**	**463.9**	**446.1**

Source: S&P Capital IQ, accessed April 2017.

Note: Tiffany settled a lawsuit with Swiss watch company Swatch for $480.2 million in March 2014 related to a joint venture that Tiffany was accused of blocking and delaying. Maggie McGrath, "Half-Billion Swatch Settlement Drags Tiffany Fourth Quarter Earnings To A Loss." Forbes, March 2014 https://www.forbes.com/sites/maggiemcgrath/2014/03/21/half-billion-swatch-settlement-drags-tiffany-fourth-quarter-earnings-to-a-loss/#3f2890e17862. Tiffany's fiscal year ended on January 31 of the following year (i.e., fiscal year 2012 officially ended on January 31, 2013). Blue Nile's fiscal year ended on the Sunday nearest December 31.

Exhibit 7b Balance Sheets for Blue Nile and Tiffany

Fiscal Year	2012	2013	2014	2015	2013	2014	2015	2016
		Blue Nile				Tiffany		
ASSETS								
Cash And Equivalents	87.0	115.9	91.2	86.5	345.8	730.0	843.6	928.0
Short Term Investments	-	-	-	-	21.3	1.5	43.0	57.8
Total Cash & ST Investments	**87.0**	**115.9**	**91.2**	**86.5**	**367.0**	**731.5**	**886.6**	**985.8**
Accounts Receivable, Gross	2.6	3.0	2.1	3.3	199.1	205.8	217.9	238.3
Bad Debt Allowance	-	-	-	-	(10.3)	(10.6)	(11.5)	(11.5)
Accounts Receivable, Net	**2.6**	**3.0**	**2.1**	**3.3**	**188.8**	**195.2**	**206.4**	**226.8**
Other Receivables	0.9	0.5	1.6	1.3	-	-	-	-
Inventory	33.3	34.5	41.7	46.4	2,326.6	2,362.1	2,225.0	2,157.6
Prepaid Expenses and Other Curr.	1.2	1.3	1.5	1.6	244.9	220.0	190.4	203.4
Deferred Tax Assets, Curr.	0.9	1.0	-	-	101.0	-	-	-
Other Current Assets	-	0.2	-	-	-	-	-	-
Total Current Assets	**125.9**	**156.6**	**138.1**	**139.1**	**3,228.4**	**3,508.8**	**3,508.4**	**3,573.6**
Gross Property, Plant & Equipment	24.6	29.5	32.8	35.6	2,098.6	2,267.2	2,354.4	2,455.7
Accumulated Depreciation	(16.7)	(19.3)	(22.4)	(25.1)	(1,243.5)	(1,367.7)	(1,418.6)	(1,523.9)
Net Property, Plant & Equipment	**7.9**	**10.2**	**10.4**	**10.5**	**855.1**	**899.5**	**935.8**	**931.8**
Deferred Tax Assets, LT	7.8	5.5	4.2	5.1	278.4	426.1	382.8	301.8
Other Long-Term Assets	4.3	4.6	4.7	2.7	390.5	346.2	294.6	290.4
Total Assets	**145.9**	**176.9**	**157.3**	**157.4**	**4,752.4**	**5,180.6**	**5,121.6**	**5,097.6**

Fiscal Year	2012	2013	2014	2015	2013	2014	2015	2016
	Blue Nile				Tiffany			
LIABILITIES								
Accounts Payable	116.2	122.3	128.7	121.9	116.6	118.0	127.8	108.6
Accrued Exp.	12.4	9.4	9.7	9.3	110.5	105.7	99.8	123.0
Short-term Borrowings	-	-	-	-	252.4	234.0	221.6	228.7
Curr. Port of LT Debt	-	-	-	-	-	-	84.2	-
Curr. Income Taxes Payable	-	-	1.3	1.7	32.0	39.9	27.1	22.1
Unearned Revenue, Current	-	-	-	-	70.3	66.1	67.9	69.2
Other Current Liabilities	0.3	1.8	1.3	1.6	115.0	94.3	101.5	81.2
Total Current Liabilities	**129.0**	**133.4**	**141.0**	**134.6**	**696.7**	**658.0**	**729.9**	**632.8**
Long-Term Debt	-	-	-	-	751.2	882.5	790.0	878.4
Unearned Revenue, Non-Current	-	-	-	2.0	81.9	64.5	55.1	45.9
Pension & Other Post-Retire. Benefits	-	-	-	-	268.1	524.2	428.1	318.6
Other Non-Current Liabilities	2.8	2.9	2.7	2.4	220.5	200.7	189.0	193.5
Total Liabilities	**131.8**	**136.3**	**143.6**	**139.0**	**2,018.4**	**2,329.9**	**2,192.1**	**2,069.2**
Common Stock	0.2	0.0	0.0	0.0	1.3	1.3	1.3	1.2
Additional Paid In Capital	197.3	223.3	227.1	232.1	1,095.3	1,173.6	1,175.7	1,190.2
Retained Earnings	82.9	93.8	103.5	114.0	1,682.4	1,950.7	2,012.5	2,078.3
Treasury Stock	(266.0)	(276.4)	(316.7)	(327.5)	-	-	-	-
Comprehensive Inc. and Other	-	-	(0.2)	(0.2)	(58.5)	(290.5)	(278.1)	(256.2)
Total Common Equity	**14.1**	**40.6**	**13.7**	**18.5**	**2,720.4**	**2,835.1**	**2,911.4**	**3,013.5**
Minority Interest	-	-	-	-	13.5	15.6	18.1	14.9
Total Equity	**14.1**	**40.6**	**13.7**	**18.5**	**2,734.0**	**2,850.7**	**2,929.5**	**3,028.4**
Total Liabilities And Equity	**145.9**	**176.9**	**157.3**	**157.4**	**4,752.4**	**5,180.6**	**5,121.6**	**5,097.6**

Source: S&P Capital IQ, accessed April 2017.

Note: Tiffany's fiscal year ended on January 31 of the following year (i.e. fiscal year 2012 officially ended on January 31, 2013). Blue Nile's fiscal year ended on the Sunday nearest December 31. Blue Nile was taken private in 2016.

Exhibit 7c Cash Flows for Blue Nile and Tiffany

Fiscal Year:	2012	2013	2014	2015	2013	2014	2015	2016
	Blue Nile				Tiffany			
Net Income	**8.4**	**10.9**	**9.7**	**10.5**	**181.4**	**484.2**	**463.9**	**446.1**
Depreciation & Amort.	3.4	3.1	3.6	3.9	176.4	186.4	198.8	205.1
Amort. of Goodwill and Intangibles	-	-	-	-	4.2	7.8	3.7	3.4
Depreciation & Amort., Total	**3.4**	**3.1**	**3.6**	**3.9**	**180.6**	**194.2**	**202.5**	**208.5**
(Gain) Loss From Sale Of Assets	0.0	0.0	-	-	(9.5)	(9.2)	(8.3)	(8.5)
Asset Write-down & Restr. Costs	-	-	-	-	-	-	-	25.4
Bad Debt Expense	-	-	-	-	-	-	37.9	12.6
Stock-Based Compensation	5.1	5.0	4.4	5.1	32.2	26.5	24.5	24.3
Tax Benefit from Stock Options	(2.6)	(0.9)	(2.9)	(0.8)	(14.9)	(14.1)	(2.2)	(0.7)
Other Operating Activities	(0.2)	2.2	2.3	(0.9)	52.8	110.5	89.3	110.7
Change in Acc. Receivable	(0.3)	0	(0.2)	(0.3)	(23.2)	(17.6)	(16.7)	(19.2)
Change In Inventories	(4.0)	(1.3)	(7.1)	(4.7)	(168.3)	(167.6)	63.7	54.8
Change in Acc. Payable & Accr. Liab.	20.4	6.4	6.3	(6.7)	45.4	(5.9)	(15.3)	(24.6)
Change in Unearned Rev.	3.1	-	-	2.0	4.7	(2.7)	3.0	1.5
Change in Inc. Taxes	1.0	(0.2)	0.2	-	(70.1)	81.9	3.1	(39.3)
Change in Other Net Operating Assets	0.2	(1.7)	0.8	0.0	(56.4)	(65.1)	(31.8)	(89.5)
Cash from Operations	**34.4**	**23.4**	**17.2**	**8.0**	**154.7**	**615.1**	**813.6**	**702.1**
Capital Expenditure	(2.5)	(5.5)	(3.8)	(3.8)	(221.4)	(247.4)	(252.7)	(222.8)
Sale of Property, Plant, and Equipment	-	-	-	-	-	-	0.9	-
Invest. Marketable & Equity Securities	(4.0)	(0.3)	-	-	(23.5)	15.2	(26.4)	(15.7)
Other Investing Activities	-	-	-	1.4	(1.9)	15.2	-	1.7
Cash from Investing	**(6.5)**	**(5.8)**	**(3.8)**	**(2.4)**	**(246.8)**	**(217.0)**	**(278.2)**	**(236.8)**
Short Term Debt Issued	-	-	-	-	139.7	19.8	24.8	91.0
Long-Term Debt Issued	-	-	-	-	-	548.0	-	98.1
Total Debt Issued	**-**	**-**	**-**	**-**	**139.7**	**567.8**	**24.8**	**189.1**

Fiscal Year:	2012	2013	2014	2015	2013	2014	2015	2016
	Blue Nile				Tiffany			
Short Term Debt Repaid	-	-	-	-	(69.7)	(15.9)	(27.3)	(83.1)
Long-Term Debt Repaid	(0.1)	(0.1)	(0.1)	0	-	(400.0)	-	(97.1)
Total Debt Repaid	**(0.1)**	**(0.1)**	**(0.1)**	**0**	**(69.7)**	**(415.9)**	**(27.3)**	**(180.2)**
Issuance of Common Stock	8.6	21.4	2.4	1.1	27.9	42.9	2.0	15.3
Repurchase of Common Stock	(38.9)	(10.4)	(40.3)	(10.8)	-	(27.0)	(220.4)	(183.6)
Common Dividends Paid	-	-	-	-	(170.2)	(191.2)	(203.4)	(218.8)
Total Dividends Paid	**-**	**-**	**-**	**-**	**(170.2)**	**(191.2)**	**(203.4)**	**(218.8)**
Other Financing Activities	-	0.4	(0.1)	(0.5)	6.9	0	2.0	(4.6)
Cash from Financing	**(30.3)**	**11.2**	**(38.1)**	**(10.2)**	**(65.4)**	**(23.4)**	**(422.3)**	**(382.8)**
Foreign Exchange Rate Adj.	-	0.1	(0.1)	(0.1)	(1.5)	9.5	0.5	1.9
Net Change in Cash	**(2.4)**	**28.9**	**(24.8)**	**(4.6)**	**(159.0)**	**384.2**	**113.6**	**84.4**

Source: S&P Capital IQ, accessed April 2017.

Note: Tiffany's fiscal year ended on January 31 of the following year (i.e. fiscal year 2012 officially ended on January 31, 2013). Blue Nile's fiscal year ended on the Sunday nearest December 31. Blue Nile was taken private in 2016.

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