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Restoration Hardware Holdings Inc
Form 10-K
March 30, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended January 30, 2016

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the transition period from _____ to _____

Commission file number: 001-35720

RESTORATION HARDWARE HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

15 Koch Road, Suite K
Corte Madera, CA

45-3052669
(I.R.S. Employer
Identification Number)
94925

(Zip Code)

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(Address of principal executive offices)

Registrant's telephone number, including area code: (415) 924-1005

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$0.0001 par value New York Stock Exchange, Inc.

(Title of class) (Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 31, 2015, the last business day of the registrant's most recently completed second quarter, the approximate market value of the registrant's common stock held by non-affiliates was \$2,794,100,000. Solely for purposes of this disclosure, shares of common stock held by executive officers and directors of the registrant as of such date have been excluded because such persons may be deemed to be affiliates.

As of March 25, 2016, 40,583,845 shares of registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for its 2016 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report on Form 10-K where indicated. Such proxy statement will be filed with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended January 30, 2016.

RESTORATION HARDWARE HOLDINGS, INC.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS AND MARKET DATA

This annual report contains forward-looking statements that are subject to risks and uncertainties. Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business. You can identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. These statements may include words such as “anticipate,” “estimate,” “expect,” “project,” “plan,” “intend,” “believe,” “may,” “will,” “should,” “likely” and other words and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events.

Forward-looking statements are subject to risk and uncertainties that may cause actual results to differ materially from those that we expected. We derive many of our forward-looking statements from our operating budgets and forecasts, which are based upon many detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the impact of known factors and it is impossible for us to anticipate all factors that could affect our actual results. Important factors that could cause actual results to differ materially from our expectations, or cautionary statements, are disclosed in Item 1A—Risk Factors, Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this annual report. All forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by these cautionary statements, as well as other cautionary statements. You should evaluate all forward-looking statements made in this annual report in the context of these risks and uncertainties.

We cannot assure you that we will realize the results or developments we expect or anticipate or, even if substantially realized, that they will result in the consequences or affect us or our operations in the way we expect. The forward-looking statements included in this annual report are made only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law.

PART I

Item 1. Business Overview

Restoration Hardware Holdings, Inc. (“RH” or the “Company”) is a leading luxury retailer in the home furnishings marketplace. Our curated and fully-integrated assortments are presented consistently across our sales channels in sophisticated and unique lifestyle settings that we believe are on par with world-class interior designers. We offer dominant merchandise assortments across a growing number of categories, including furniture, lighting, textiles, bathware, décor, outdoor and garden, tableware, and child and teen furnishings. Our ability to innovate, curate and integrate products, categories, services and businesses with a completely authentic and distinctive point of view, then rapidly scale them across our fully integrated multi-channel infrastructure is a powerful platform for continued long-term growth. Our unique product development, go-to-market and supply chain capabilities, together with our significant scale, enable us to offer a compelling combination of design, quality and value that we believe is unparalleled in the marketplace.

Restoration Hardware Holdings, Inc. was formed as a Delaware corporation on August 18, 2011. On November 7, 2012, Restoration Hardware Holdings, Inc. completed an initial public offering. Our business is fully integrated across our multiple channels of distribution, consisting of our stores, catalogs, including our Source Books, and websites. As of January 30, 2016, we operated a total of 69 retail galleries, consisting of 53 legacy Galleries, 6 larger format Design Galleries, 4 next generation Design Galleries, 1 RH Modern Gallery and 5 RH Baby & Child Galleries, as well as 17 outlet stores, throughout the United States and Canada.

We have achieved strong growth in sales and profitability, as illustrated by the following:

- Net revenues increased 13% to \$2,109.0 million in fiscal 2015, on top of a 20% increase in fiscal 2014 and a 30% increase in fiscal 2013.
- The fourth quarter of fiscal 2015 marked our 24th consecutive quarter of double-digit net revenue growth.
- Our adjusted net income increased 17.6% to \$114.8 million in fiscal 2015 from \$97.6 million in fiscal 2014.

Key Value Driving Strategies

Key elements of our strategy are to:

Transform Our Real Estate Platform. We believe we have an opportunity to significantly increase our sales by transforming our real estate platform from our existing legacy retail footprint to a portfolio of next generation Design Galleries that are sized to the potential of each market and the size of our assortment. On average, our legacy retail stores display less than 10% of our current product assortment. Our next generation Design Galleries allow us to optimize our selling space by displaying a greater percentage of our merchandise assortment, as well as future product expansions and new businesses, in a highly differentiated retail setting. Based on our historical performance, when a product is presented on the selling floor, we experience an increase in sales for that product across all of our channels.

Based on recent trends and our plans for product assortment expansion and new businesses, we are generally targeting a range of approximately 25,000 to 60,000 leased selling square feet for new locations. Landlords are currently offering us leases that accommodate these space requirements and that have favorable terms, which are typically available only to anchor tenants. Based on our analysis, we believe we have the opportunity to operate next generation Design Galleries in 60 to 70 locations in the United States and Canada.

Expand Our Offering and Increase Our Market Share. We believe we have a significant opportunity to increase our market share by growing our merchandise assortment, introducing new products and categories, expanding our service

offerings and exploring and testing new business opportunities complementary to our core business. We will continue to increase our brand awareness and customer loyalty through our circulation strategy, our digital marketing initiatives, and our advertising and public relations activities and events.

Elevate the Customer Experience. We are focused on improving the end-to-end customer experience. As we have elevated our brand, especially at retail, other customer touch points also need to leapfrog forward to create a cohesive experience. This initiative will focus on everything from product quality to in-home delivery across all channels, and includes new people, processes, and systems.

Increase Operating Margins. We have the opportunity to continue to improve our operating margins by leveraging our fixed occupancy, advertising and corporate general and administrative costs, as well as leveraging our scalable infrastructure. Key areas in which we believe we will increase operating margins include:

- Occupancy Leverage—We believe that our real estate transformation will allow us to better leverage our fixed occupancy costs. Our next generation Design Galleries are expected to generate increased sales volumes in each market. We expect that these increased sales volumes, coupled with the favorable anchor tenant-type economics and lower rent per square foot, as compared to our legacy Galleries, will provide significant leverage of our retail occupancy costs. We also expect leverage in our supply chain occupancy as we optimize our inventory investments over time and further leverage our distribution center infrastructure.
- Advertising Cost Leverage—We believe the physical expression and retail experience in our next generation Design Galleries serve as the best form of advertising for RH. Our next generation Design Galleries are expected to generate increased sales volumes in each market as compared to the legacy Gallery in that market. As a result, the higher sales volumes achieved will leverage our fixed advertising expenditures in each market. We also continue to explore opportunities to further optimize our Source Book strategy and enhance our on-line marketing initiatives.
- Improved Product Margin & Shipping Efficiencies—We believe we can obtain additional operating margin expansion from improved product margins and shipping efficiencies. We believe we have pricing power that should continue to improve as we continue to take market share in the highly-fragmented luxury home furnishings market. As our newer categories and products gain scale, we also expect improved vendor pricing. In addition, we anticipate further efficiencies of in-sourcing our home delivery locations and opportunities to optimize our shipping model over time.
- Other Selling, General and Administrative Expenses—We believe we still have significant opportunity to leverage our fixed corporate and other general and administrative expenses as we increase our sales.

Pursue International Expansion. We plan to strategically expand our business into select countries outside of the United States and Canada in the future. We believe that our luxury brand positioning and unique aesthetic will have strong international appeal.

Products and Product Development

We have positioned RH as a lifestyle brand and design authority by offering dominant merchandise assortments. We are merchants of luxury home furnishings and our luxury products embody our design aesthetic and reflect inspiration from across the centuries and around the globe.

We have developed a proprietary product development platform that is fully integrated from ideation to presentation. Key aspects of our product development platform are:

- Organization—We have established a collaborative, cross-functional organization centered on product leadership and coordinated across our product development, sourcing, merchandising, inventory and creative teams. Our product teams are focused on maximizing the sales potential of each product category across all channels, which eliminates channel conflicts and functional redundancies.
- Process—For many of our products, we work closely with our network of artisan partners who possess specialized product development and manufacturing capabilities and who we consider an extension of our product development team. We collaborate with our global network of specialty vendors and manufacturers to produce artisanal pieces on a large scale with a high level of quality and value, including both distinctive original designs and reinterpretations of antiques.
- Facility—We have built the RH Center of Innovation and Product Leadership, a facility which supports the entire product development process from product ideation to presentation for all channels.

As a result of our proprietary organization, process and facility, our typical product lead times are 3 – 9 months, which enhances our ability to introduce more new products with each collection. In addition, our product development platform, sourcing capabilities and significant scale enable us to reduce our product costs.

Sales Channels

We distribute our products through a fully integrated sales platform comprised of our stores, catalogs and websites. We believe the level of integration among all of our channels and our approach to the market distinguishes us from most other retailers. For fiscal 2015, sales of products originating in our stores represented 51% of our net revenues, while sales from our direct business represented 49% of our net revenues. We believe our channels complement each other and our customers' buying decisions are influenced by their experiences across more than one of our sales channels. We encourage our customers to shop across our channels and have aligned

our business and internal organization to be channel agnostic. Our integrated distribution and product delivery network serves all of our channels. We believe the key advantage of our multiple sales channels is our ability to leverage the unique attributes of each channel in our approach to the market.

Stores

Retail Galleries

Our retail galleries are located primarily in upscale malls and street locations, as well as in iconic locations. We believe situating our galleries in desirable locations with high visibility is critical to the success of our business, and we identify gallery locations based on several store specific aspects including geographic location, demographics, and proximity to other high-end specialty retail stores. We pursue a market-based sales strategy, whereby we assess each market's overall sales potential and how best to approach the market across all of our channels. We customize square footage and catalog circulation to maximize each market's sales potential and increase our return on invested capital.

Our retail galleries reinforce our luxury brand aesthetic and are highly differentiated from other home furnishings retailers. We have revolutionized the customer experience by showcasing products in a sophisticated lifestyle setting that we believe is on par with world-class interior designers, consistent with the imagery and product presentation featured in our catalogs and on our websites. Products in our galleries are presented in fully appointed rooms, emphasizing collections over individual pieces. This presentation encourages a higher average order value as customers are inspired to consider purchasing a full collection of products to replicate the design aesthetic experienced in our galleries. In addition, because less than 10% of our merchandise assortment is displayed in our legacy Galleries, our store associates use iPads and other devices to allow customers to shop our entire merchandise assortment while in the gallery.

During fiscal 2015, we opened RH Chicago, The Gallery at the Three Arts Club in Chicago's Gold Coast. This first-of-its-kind retail concept represents our initial foray into hospitality with a seamlessly integrated culinary offering, which includes the 3 Arts Club Café, the 3 Arts Club Wine Vault & Tasting Room, and the 3 Arts Club Pantry & Espresso Bar.

We define leased selling square footage as retail space at our stores used to sell our products. Leased selling square footage excludes backrooms used for storage, office space or similar purpose, as well as exterior sales space located outside a store, such as courtyards, gardens and rooftops. We currently operate five distinct store types with the following average leased selling square footage as of January 30, 2016:

- 1) Next generation Design Galleries; which include our Galleries in Atlanta, Chicago, Denver and Tampa, and which average approximately 43,000 leased selling square feet;
- 2) Initial larger format Design Galleries; which include our Galleries in Houston, Scottsdale, Boston, Indianapolis, Greenwich, and Los Angeles, and which average approximately 19,000 leased selling square feet;
 - 3) Legacy Galleries, which average approximately 8,000 leased selling square feet;
- 4) The RH Modern Gallery, which is located in Los Angeles and is approximately 13,000 leased selling square feet; and
 - 5) RH Baby & Child Galleries, which average approximately 4,000 leased selling square feet.

We continue to evaluate potential opportunities for stand-alone RH Baby & Child, RH Teen and RH Modern Galleries in key markets.

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As of January 30, 2016, we operated a total of 69 retail galleries throughout the United States and Canada, consisting of 53 legacy Galleries, 6 larger format Design Galleries, 4 next generation Design Galleries, 1 RH Modern Gallery and 5 RH Baby & Child Galleries. The following list shows the number of retail galleries in each U.S. state and each Canadian province where we operate as of January 30, 2016:

Location	Store	Location	Store	Location	Store
Alabama	1	Massachusetts	1	Tennessee	1
Arizona	1	Michigan	1	Texas	6
California	17	Minnesota	1	Utah	1
Colorado	1	Missouri	2	Virginia	2
Connecticut	3	New Jersey	2	Washington	1
Florida	5	New York	2	District of Columbia	1
Georgia	1	North Carolina	2	Alberta	2
Illinois	2	Ohio	3	British Columbia	1
Indiana	1	Oklahoma	1	Ontario	2
Louisiana	1	Oregon	1		
Maryland	1	Pennsylvania	2		
Total					69

The table below highlights certain information regarding our retail stores opened and closed during the last three fiscal years.

	Fiscal Year		
	2015	2014	2013
Stores open at beginning of period	67	70	71
Stores opened	8	3	2
Stores closed	6	6	3
Stores open at end of period	69	67	70

We continually analyze opportunities to selectively consolidate stores in connection with openings of our next generation Design Galleries or close stores that have been under-performing or are no longer consistent with our brand positioning. In many cases, we continue to operate a store until its lease has expired in order to effect the closure in a cost-efficient manner.

Outlet Stores

As of January 30, 2016, we operated 17 outlet stores in 12 states in the United States and Canada. Our outlet stores are branded as Restoration Hardware Outlet or RH Outlet and are primarily located in large outlet malls. Our outlet stores serve as an efficient means to sell discontinued or irregular inventory outside of our core sales channels.

E-Commerce

Our primary websites, www.restorationhardware.com, www.rh.com and www.rhbabyandchild.com, provide our customers with the ability to purchase our merchandise online. In September 2015, we launched www.rhteen.com and www.rhmodern.com, e-commerce enabled websites devoted to our teen furnishings category and to our modern product assortment.

Our e-commerce platform allows our customers to experience the RH lifestyle reflected in our catalogs and throughout our stores, and to shop substantially all of our current product assortment. We update our websites regularly to reflect product availability and special offers.

The websites also offer room-based navigation, which allows the customer to envision and shop items by room or by product, expanding on the richness of the online experience. For example, customers can search our websites for products by size or color, browse through our extensive product categories and see detailed information about each item and collection, such as dimensions, materials and care instructions. Additionally, customers can select color swatches and view merchandise displayed with different color and fabric options.

Source Books

We produce a series of catalogs, which we refer to as Source Books, to showcase our merchandise assortment. In fiscal 2015, these included our Interiors, Outdoor, RH Modern, RH Teen, RH Baby & Child, Small Spaces, Bath, Linens, Rugs, Lighting and Holiday Source Books. Our Source Books, which showcase nearly our entire product assortment, are one of our primary branding and advertising vehicles. We have found that when we display a greater merchandise assortment in our Source Books, we experience increased sales across all of our channels. As in our retail stores, our Source Books present our merchandise in lifestyle settings that reflect our unique design aesthetic. Our Source Books also feature profiles of select artisan vendors and other compelling editorial content regarding home décor. All creative work on our Source Books is coordinated in-house in our RH Center of Innovation & Product Leadership, providing us greater control over the brand image presented to our customers, while also reducing our Source Book production costs.

Our Source Book mailings serve as a key driver of sales through both our websites and retail stores. Our customers respond to the Source Books across all of our channels, with sales trends closely correlating to the assortments that we emphasize and feature prominently both in our Source Books and in our stores. We continue to evaluate and optimize our Source Book strategy based on our experience.

We maintain a database of customer information, which includes sales patterns, detailed purchasing information, certain demographic information, geographic locations and mailing and email addresses. We mail our Source Books to addresses within this database and to addresses provided to us by third parties. The database supports our ability to analyze our customers' buying behaviors across sales channels and facilitates the development of targeted marketing strategies, and is maintained in accordance with our privacy policy disclosed on our website. We segment our customer files based on multiple variables, and we tailor our Source Book mailings and emails in response to the purchasing patterns and product needs of our customers. We focus on continually improving the segmentation of customer files and the expansion of our customer database.

Our Source Books, in concert with our e-commerce channel, are a cost-effective means of testing new products, and allow us to launch categories in a disciplined, expeditious and cost-effective manner.

Phone Orders

In addition to making purchases in our stores or online, customers, including those from our Trade and Contract businesses, can place orders over the phone by calling our customer service associates. In fiscal 2015, phone orders represented approximately 11% of net revenues.

Trade and Contract

In addition to our core channels, we continue to expand into professional services channels, including Trade and Contract. In the Trade channel, we work directly with independent interior designers purchasing for their businesses. Separately, we sell directly to customers who make purchases with the assistance of their own interior designers or decorators, which we refer to as "designer-assisted sales." Our Contract business services hospitality, real estate development and other business clients. These channels offer additional avenues for reaching new customers, including both businesses and individuals.

Marketing and Advertising

We employ a variety of marketing and advertising vehicles to drive customer traffic across all our channels, strengthen and reinforce our brand image and acquire new customers. These include targeted Source Book circulation,

promotional mailings, email communications, online and print advertisements, and public relations activities and events. We maintain a database of customers, which includes sales patterns, detailed purchasing information, certain demographic information, geographic locations and mailing and email addresses. We use our customer database to tailor our programs and increase productivity of our marketing and promotion initiatives. We leverage our marketing and advertising expenses across all our channels as we seek to optimize the efficiency of our investment.

Our stores and our Source Books are the primary branding and advertising vehicles for the RH brands. The highly-differentiated design aesthetic and shopping environment of our stores drive customer traffic not only to our stores but also to our direct channels. Our Source Books and targeted emails further reinforce the RH brand image and drive sales across all of our sales channels. We also engage in a wide range of other marketing, promotional and public relations activities to promote our brands. These campaigns include media coverage in design, lifestyle, culture/society and specialty publications, as well as in-store events related to new store openings and product launches. We also engage print advertising in brand-relevant publications such as Architectural Digest, DuJour,

Elle Décor, Town and Country, Veranda and others, and from time to time have also engaged in online advertising. We believe that these efforts will drive increased brand awareness, leading to higher sales in our stores and our direct business over time.

Sourcing

We primarily contract with third-party vendors for the manufacture of our merchandise. Our sourcing strategy focuses on identifying and using vendors that can provide the quality materials and fine craftsmanship that our customers expect of our brand. To ensure that our high standards of quality and timely delivery of merchandise are met, we work closely with vendors and manufacturers. Our products are generally made from readily available raw materials. We seek to ensure the consistent quality of our manufacturers' products by selectively inspecting pre-production samples, conducting periodic site visits to certain of our vendors' production facilities and selectively inspecting inbound shipments at our distribution facilities. In fiscal 2015, we sourced approximately 75% of our purchase dollar volume from approximately 30 vendors. In fiscal 2015, one vendor accounted for approximately 12% of our purchase dollar volume. Based on total dollar volume of purchases for fiscal 2015, approximately 82% of our products were sourced in Asia, the majority of which originated from China, 11% from the United States and the remainder from other regions.

RH is committed to offering safe, legal, high quality products, made consistently with our values. RH has a Compliance and Social Responsibility team dedicated to ensuring we keep these commitments through product testing, audits and other verification methods. Product testing is a core process for our organization. In fiscal 2014, RH Baby & Child received GREENGUARD Gold Certification of nursery furniture, which demonstrates that these products are low-emitting, thus contributing to better indoor air quality. GREENGUARD Gold Certified products aid in the creation of healthier indoor environments, by emitting fewer airborne compounds that can contribute to health issues including asthma and other respiratory conditions. We are in the process of obtaining GREENGUARD Gold Certification for all of our furniture products.

We have a limited number of long-term merchandise supply contracts, but we believe that we generally have strong relationships with our product vendors. Although we transact business primarily on an order-by-order basis, we typically work with many of our vendors over extended periods of time, and many vendors are making long-term capacity investments to serve our increasing demands. Over the last several years, we engaged in a sourcing initiative to develop closer relationships with our vendors in order to achieve better efficiencies and further improve our product development process. Through this process, we have eliminated the use of most third party purchasing agents in favor of a model in which we directly manage our vendors. We have achieved significant cost savings and other efficiencies from this initiative.

Distribution and Delivery

We manage the distribution and delivery of our products through our six distribution centers, which are located strategically throughout the United States. Each of our distribution centers serves all of our sales channels.

We offer a white glove home delivery service for our larger merchandise and furniture categories, where delivery personnel assist our customers by delivering fully assembled items to the location of their choice. We operate portions of our home delivery services in ten key markets to leverage operating costs and improve our customers' delivery experience, while reducing returns and damage to our products. We plan to continue to in-source these services in additional markets over time.

Through expansions and upgrades to our warehousing, distribution and delivery operations, we have improved our supply chain and fulfillment capabilities, and have built a scalable infrastructure with significant capacity to support

our future growth. We believe our enhanced supply chain and fulfillment operations allow us to manage customer orders and distribute merchandise to stores and customers in an efficient and cost-effective manner. We also believe that these upgrades have improved customer satisfaction by reducing delivery times, reducing damage to merchandise, and improving our customer's overall buying experience.

We intend to continue to strengthen our supply chain operations through a number of key initiatives in fiscal 2016 designed to improve our fulfillment and delivery logistics performance and to achieve greater efficiencies in the management of our inventories.

Management and Information Technology

We use industry-standard information technology systems to provide customer service, business process support, and business intelligence across our sales channels. Our technology team continues to upgrade several of our core systems, including:

- Implementing enhanced in-store, web, and care center customer service and commerce technology to provide enhanced capabilities to support our luxury customer experience;
- Optimizing and enhancing inventory management capabilities to improve inventory productivity and service levels across our supply chain;
- Implementing enhanced special order capabilities optimizing processes to support our increasingly expanding product assortment;
- Upgrading our web commerce and in-store capabilities with state-of-the art technology to optimize performance and improve the customer shopping experience;
- Implementing supply chain technology and enhancements to support our expanding supply chain network improving operating efficiencies, accuracy, and service levels; and
- Optimizing and enhancing our enterprise data warehouse platform to expand data analysis areas to allow more timely and complete analysis of current business trends, results, and comparisons to our historical performance.

We believe these substantial upgrades to our information technology systems provide management with the ability to drive ongoing improvement in our operating model, focus on efficiency opportunities, and increase management control. New access to results through our technology tools also equips management to more timely identify, analyze and respond to business trends.

Over the next several years, we intend to further enhance our IT capabilities to support our growth. Key initiatives include:

- Further enhancing our delivery, order orchestration, inventory optimization, procurement, order management and vendor collaboration solutions to maximize operating efficiencies focused on enhancing the end-to-end customer experience; and
- Continuing our expansion and redefinition of business intelligence capabilities to optimize information for timely decision making in areas such as supply chain and customer experience.

We are committed to a high level of integration in technology across our business. We believe our approach to technology demonstrates an appropriate balance of strategic planning and innovation to support both today's business and tomorrow's growth.

Competition

The home furnishings industry is highly competitive. We primarily compete against a large number of independent retailers that provide unique items and custom-designed product offerings at high price points, including antique dealers and home furnishings retailers who market to the interior design community. We also compete with national and regional home furnishings retailers and department stores, as well as with mail order catalogs and online retailers focused on home furnishings.

We believe we compete primarily on the basis of design, quality, value and customer service. We believe our distinct combination of design, quality and value allows us to compete effectively and we believe we differentiate ourselves from competitors based on the strength of our brand, products and our fully integrated multi-channel business model. We compete with the interior design trade and specialty merchants by providing a broader product assortment at an exceptional value based both upon the price and quality of our products. We compete against certain other home furnishings retailers primarily by offering what we believe are superior quality, highly distinctive design styles and a

sophisticated lifestyle presentation in our product offering.

We also believe that our success depends in substantial part on our ability to originate and define product trends, as well as to timely anticipate, gauge and react to changing consumer demands. Certain of our competitors are larger and have greater financial, marketing and other resources than us. However, many smaller specialty retailers may lack the financial resources, infrastructure, scale and national brand identity necessary to compete effectively with us. We believe we are effectively positioned between these two market segments to gain market share and drive growth.

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Employees

As of January 30, 2016, we had approximately 4,600 employees, of which approximately 800 were part-time employees. As of that date, approximately 2,200 of our employees were based in our stores. None of our employees are represented by a union, and we have had no labor-related work stoppages. We believe our relations with our employees are good.

Intellectual Property

The “RH”, “Restoration Hardware,” “RH Baby & Child,” “RH Modern,” and “RH Teen” trademarks, among others, are registered or are the subject of pending trademark applications with the United States Patent and Trademark Office and with the trademark registries of several foreign countries. Each of our trademark registrations is perpetually renewable provided that we use or continue to use the trademarks in commerce in the particular geographic market and for the goods or services covered by the registration. In addition, we own many domain names, including “restorationhardware.com,” “rh.com,” “rhhbabyandchild.com,” “rhmodern.com,” and “rhteen.com” and others that include our trademarks. These domain names are perpetually renewable. We own design patents or pending applications to protect the ornamental appearance of several of our products. These design patents are valid for 14 years from the date of issuance. We own copyrights, including copyright registrations or pending applications, for several of our Source Books. We believe that our trademarks, design patents, and copyrights have significant value and we will vigorously protect them against infringement.

Fluctuation in Quarterly Results

Our quarterly results have historically varied depending upon a variety of factors, including our product offerings, promotional events, store openings, shifts in the timing of holidays and the timing of Source Book releases, among other things. As a result of these factors, our working capital requirements and demands on our product distribution and delivery network may fluctuate during the year. Unique factors in any given quarter may affect period-to-period comparisons between the quarters being compared, and the results for any quarter are not necessarily indicative of the results that we may achieve for a full fiscal year.

Regulation and Legislation

We are subject to numerous regulations, including labor and employment laws, customs, laws governing truth-in-advertising, consumer protection, privacy, safety, real estate, environmental and zoning and occupancy laws, and other laws and regulations that regulate retailers and govern the promotion and sale of merchandise and the operation of our galleries, outlets and warehouse facilities, both in the United States and Canada, as well as in jurisdictions from which we source our products. We believe we are in material compliance with laws applicable to our business.

Where You Can Find More Information

We are required to file annual, quarterly and current reports, proxy statements and other information required by the Securities Exchange Act of 1934, as amended, with the SEC. You may read and copy the reports and other information we file with the SEC at the SEC’s Public Reference Room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may also obtain copies of this information by mail from the public reference section of the SEC, 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. You may obtain information regarding the operation of the public reference room by calling 1-800-SEC-0330. The SEC also maintains a website that contains reports, proxy statements and other information about issuers, like us, who file electronically with the SEC. The address of that website is <http://www.sec.gov>.

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We maintain public internet sites at www.restorationhardware.com and www.rh.com and make available, free of charge, through these sites our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and Forms 3, 4 and 5 filed on behalf of directors and executive officers, as well as any amendments to those reports filed or furnished pursuant to the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. We also put on our websites the charters for our Board of Directors' Audit Committee, Compensation Committee, and Nominating and Corporate Governance Committee, as well as our Code of Business Conduct, our Corporate Governance Guidelines and Code of Ethics governing our chief executive and senior financial officers and other related materials. The information on our websites is not part of this annual report.

Our Investor Relations Department can be contacted at Restoration Hardware, Inc., 15 Koch Road, Suite K, Corte Madera, CA 94925, Attention: Investor Relations; telephone: 415-945-3500; e-mail: investorrelations@rh.com.

Item 1A. Risk Factors

Certain factors may have a material adverse effect on our business, financial condition, and results of operations. You should consider carefully the risks and uncertainties described below, in addition to other information contained in this Annual Report on Form 10-K, including our consolidated financial statements and related notes. If any of the following risks actually occurs, our business, financial condition, results of operations, and future prospects could be materially and adversely affected. In that event, the trading price of our common stock could decline, and you could lose part or all of your investment. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may also become important factors that adversely affect our business.

Risks Related to Our Business

We have experienced a high rate of growth in our business during the last several years that may not be sustained and may not generate a corresponding improvement in our results of operations.

We may not be able to maintain the high levels of growth in our business that we have experienced during the last several years. Although we have continued to experience sales growth, the rate of sales growth in some recent quarters has been slower than in prior periods. We attribute recent changes in our rate of sales growth to a variety of factors, including a slowdown in certain markets in which we operate, as well as some other specific factors such as slower than anticipated deliveries of some products from our vendors. In addition, as the size of our business grows, we would have to achieve increased incremental growth in each future period, in terms of actual sales volume, in order to sustain the same percentage rate of growth as that which we have achieved in prior periods. Finally, the current economic climate in the beginning of 2016 appears uncertain and we are not able to predict if there will be a larger slowdown in economic activity in the United States and Canada, including a possible recession. If a significant slowdown or recession were to develop, either broadly or in select portions of the economy such as the housing market or the market for higher-priced housing, our business would likely be adversely affected.

In addition, sales growth may be adversely affected if favorable customer responses to our product offerings and store formats are not sustained. We have introduced new product assortments in recent years, including RH Modern and RH Teen. Although we anticipate a favorable response to these new product offerings, there can be no assurance that we will favorably execute on all the elements required for introduction of a new merchandise category such as RH Modern. A successful introduction of new product assortments requires that we successfully anticipate customer demand for new products and styles, that we create the right product assortment within the new category, that our marketing of the new products is able to reach potential customers, and that we successfully source the right products in the right quantities and at the right price to satisfy customer demand. We are likely to encounter some elements of uncertainty with the introduction of a new product assortment as we estimate the quantity of such products in anticipation of customer demand. It is not uncommon to overestimate or underestimate demand for specific products as we assess potential customer demand across a range of new products. In addition, even where we have the right products and favorable merchandising, other factors may slow our ability to fulfill customer orders such as backlog in production at specific vendors or other manufacturing challenges as vendors produce new products in quantity. For instance, we encountered difficulties with respect to the introduction of RH Modern despite favorable reception by customers because our vendors were not able to produce demanded amounts of products at the required quality level. Any of the above factors can adversely affect both our revenue from quarter to quarter and our results of operations.

Our strategy in opening newer and larger store formats typically involves closing legacy stores in the same market area. Although we believe this approach has generally been successful in the past, there can be no assurance that it will continue to be successful in particular new markets. While our objective is to migrate a high percentage of customer demand when we choose to close a store in a particular location in favor of a next generation Design Gallery in the same or an adjacent market location, there can be no assurance that we will be successful in doing so.

In addition, comparable brand revenue growth is another measure of the rate of growth in our business. For the reasons stated above, we have recently experienced a decline in the rate of comparable brand revenue growth in recent quarters compared to prior periods. Our rate of revenue growth and comparable brand revenue growth have sharply fluctuated from quarter to quarter over the last three years.

As a high growth business, we expect volatility in the rates of our growth to continue in future quarterly periods. Unique factors in any given quarter may affect period-to-period comparisons such as sales promotions or other changes in the business between the two quarters being compared. The results for any quarter are not necessarily indicative of the results that we may achieve for a full fiscal year. Our results of operations may also vary relative to corresponding periods in prior years. We may take certain pricing, merchandising or marketing actions that could have a disproportionate effect on our business, financial condition and results of operations in a particular quarter or selling season, and we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and cannot be relied upon as indicators of future performance.

Numerous other factors affect period-to-period comparisons in our revenue and comparable brand revenue growth, including:

- the overall economic and general retail sales environment;
- the number, size and location of stores we open, close, remodel or expand in any period;
- consumer preferences and demand;
- our ability to efficiently source and distribute products;
- changes in our product offerings and the introduction and timing of introduction of new products and new product categories;
- promotional events;
- our competitors introducing similar products or merchandise formats;
- current local and global economic conditions;
- the timing of various holidays, including holidays with potentially heavy retail impact;
- changes in Source Book circulation, and the number of pages in our Source Books and timing of mailing; and
- the success of our marketing programs.

Other future developments in our business could also result in material changes in our operating costs, including increased merchandise inventory costs and costs for paper and postage associated with the mailing and shipping of Source Books and products. We cannot assure you that we will succeed in offsetting any such expenses with increased efficiency or that cost increases associated with our business will not have an adverse effect on our financial results.

We are undertaking a large number of business initiatives at the same time, including exploring opportunities to expand into new categories and complementary businesses, through either organic growth or strategic acquisitions. If these initiatives are not successful, they may have a negative impact on our results of operations.

We have experienced rapid growth and are continuing to undertake a large number of new business initiatives in order to support our future growth. For example, we have developed and continue to refine and enhance our Gallery format, which involves larger store square footage. We plan to continue to open larger format Design Galleries in select major metropolitan markets and we expect to close a number of legacy Galleries and replace them with our next generation Design Gallery format. We also continue to add new product categories and to expand product assortments. For example, last year we introduced our new RH Modern and RH Teen categories. We also continue to add new brand-enhancing offerings, such as the recent introduction of our food and beverage operations at the 3 Arts Club Café in the RH Gallery in Chicago and at Ma(i)sonry in Yountville, California, and we plan to include food and beverage offerings in other stores in the future. We are currently contemplating other new product lines and extensions and complementary brand-enhancing businesses, such as the expansion of our product sales to international markets and providing brand-enhancing offerings in hospitality. In addition, we are continuing a number of new initiatives to improve the operations of our business, including by enhancing and optimizing our product sourcing capabilities, improving our distribution and delivery of products to our customers and adding new management information systems. Further, our Source Book strategy continues to evolve. We often have in the past, and may in the future, incur significant costs for any new initiative before we realize any corresponding revenue with respect to such initiative.

As part of exploring growth opportunities, we may acquire from time to time value-creating, add-on businesses that broaden our existing position and market reach. However, there can be no assurance that we will be able to find suitable businesses to purchase, that we will be able to acquire such businesses on acceptable terms, or that all closing conditions will be satisfied with respect to any pending acquisition. If we are unsuccessful in our acquisition efforts, then our ability to continue to grow at rates we anticipate could be adversely affected. In addition, we face the risk that a completed acquisition may underperform relative to expectations. We may be unable to achieve synergies originally anticipated, exposed to unexpected liabilities or unable to sufficiently integrate completed acquisitions into our current business and growth model. Further, if we fail to allocate our capital appropriately, in respect of either our acquisitions

or organic growth in our operations, we could be overexposed in certain markets and geographies and unable to expand into adjacent products or markets.

We recently introduced the RH Grey Card program, which provides a range of benefits to our customers in return for payment of an annual membership fee. We have introduced the RH Grey Card in order to move our primary business away from its traditional reliance on promotions and discounts. The RH Grey Card program is new to our business and has not been tested prior to its

introduction. This program may not achieve market acceptance or may result in a loss of sales due to our elimination or changes to our other promotions and discounts.

Developing and testing new and multiple business opportunities and strategies often requires knowledge in areas of expertise that may be new to our organization and may require significant time of our management and resources. Such new business opportunities may not achieve market acceptance or may only achieve market acceptance in limited geographic areas or at certain Design Galleries. Further, these new business opportunities may generate sufficient revenue to recoup the cost of developing and operating such new concepts, which in turn could have a material adverse effect on our results of operations. Any new businesses we enter may also expose us to additional laws, regulations and risks, including the risk that we may incur ongoing operating expenses in such businesses in excess of revenues, which could harm our results of operations and financial condition. The financial profile of any such new businesses may be different than our current financial profile, which could affect our financial performance and the market price for our common stock. Additionally, if we are not successful in managing our current growth and the large number of new initiatives that are underway, we might experience an adverse impact on our financial performance and results of operations.

All of the foregoing risks may be compounded due to various factors including any economic downturn. If we fail to achieve the intended results of our current business initiatives, or if the implementation of these initiatives is delayed or abandoned, diverts management's attention or resources from other aspects of our business or costs more than anticipated, we may experience inadequate return on investment for some or all such business initiatives, which could have a material adverse effect on our results of operations.

Changes in consumer spending and factors that influence spending of the specific consumers we target, including the health of the high-end housing market, may significantly impact our revenue and results of operations.

We target consumers of high-end home furnishings as customers for our products. As a result, we believe that our sales are sensitive to a number of factors that influence consumer spending generally, but are particularly affected by the health of the higher end customer and demand levels from that customer demographic. In addition, not all macroeconomic factors are highly correlated in their impact on lower end housing versus the higher end customer. Demand for lower priced homes and first time home buying may be influenced by factors such as employment levels, interest rates, demographics of new household formation and the affordability of homes for the first time home buyer. The higher end of the housing market may be disproportionately influenced by other factors including the number of foreign buyers in higher end real estate markets in the U.S., the number of second and third homes being sold, stock market prices and the perceived prospect for capital appreciation in higher end real estate. Although employment levels in the U.S. were reasonably strong at the beginning of 2016, there can be no assurance that some of the other macroeconomic factors described above will not adversely affect the higher end consumer that we believe makes up the bulk of our customer demand.

We believe that a number of these factors have in the past had, and may in the future have, an adverse impact on the high-end retail home furnishings sector, and have also affected our business and results. These factors may make it difficult for us to accurately predict our operating and financial results for future periods and some of these factors could contribute to a material adverse effect on our business and results of operations.

If we are unable to maintain and enhance our brand or market our product offerings, we may be unable to attract a sufficient number of customers or sell sufficient quantities of our products.

Our business depends in part on a strong brand image, and we continue to invest in the development of our brand and the marketing of our business. We believe that the brand image we have developed, and the lifestyle image associated with our brand, have contributed significantly to the success of our business to date. We also believe that maintaining

and enhancing our brand is integral to the future of our business and to the implementation of our strategies for expanding our business. This will require us to continue to make investments in areas such as marketing and advertising, as well as the day-to-day investments required for store operations, Source Book mailings, website operations and employee training. Our brand image may be diminished if new products, services or other businesses, including our food and beverage operations at the 3 Arts Club Café in the RH Gallery in Chicago, and Ma(i)sonry in Yountville, California, fail to maintain or enhance our distinctive brand image.

Additionally, our reputation could be jeopardized if we fail to maintain high standards for merchandise and service quality. With the growth in importance and the impact of social media over the last few years, any negative publicity from product defects or failures in service may be magnified and reach a large portion of our customer base in a very short period of time, which could harm the value of our brand and, consequently, our financial performance could suffer. We may also suffer reputational harm if we fail to maintain high ethical, social and environmental standards for all of our operations and activities, if we fail to comply with local laws and regulations or if we experience other negative events that affect our image or reputation. Any failure to maintain a strong brand image could have an adverse effect on our sales and results of operations.

Our failure to successfully manage the strategy and costs of our Source Book mailings or other promotional programs and costs could have a negative impact on our business.

Source Book mailings are an important component of our business. We continue to adjust and refine our Source Book mailing strategy and we expect to do so in the future. For example, in fiscal 2013, we continued expanding the page counts of our Source Books, and in the same year, we also reduced the frequency of Source Books circulated to one mailing per year. In fiscal 2014 and fiscal 2015, we reduced the number of Source Books circulated. We intend to continue adjusting our Source Book circulation strategy based on a variety of factors, including the success of the various changes that we adopt. We can provide no assurances as to the success of any Source Book strategy we pursue. Increased expenditures on our catalog strategy may result in the production of too many Source Books, which could negatively affect our operating margins. Reducing expenditures on our catalog strategy, however, could overly restrict catalog circulation and have a negative effect on our revenues. Additionally, due to the size of our Source Books we have in the past received negative publicity from environmental groups. If we fail to adequately adjust our catalog strategy to meet our goals, or if our catalog strategy is unsuccessful, our results of operations could be negatively impacted.

We also rely on customary discounts from the basic shipping rate structure that are available for our catalog mailings, which could be changed or discontinued at any time, and we are subject to fluctuations in the market price for paper, which has historically fluctuated significantly and may continue to fluctuate in the future. Future increases in shipping rates, paper costs or printing costs would have a negative impact on our results of operations to the extent that we are unable to offset such increases through increased sales or by raising prices, by implementing more efficient printing, mailing, delivery and order fulfillment systems, or by using alternative direct-mail formats.

We have historically experienced fluctuations in customer response to our Source Books. Customer response depends substantially on product assortment, product availability and creative presentation, the selection of customers to whom the catalogs are mailed, changes in mailing strategies, page size, page count, frequency and timing of delivery of catalogs, as well as the general retail sales environment and current domestic and global economic conditions. The failure to effectively produce or distribute our catalogs could affect the timing of catalog delivery. The timing of catalog delivery has also been and can be affected by shipping service delays. Any delays in the timing of catalog delivery could cause customers to forgo or defer purchases. If the performance of our catalogs declines, if we misjudge the correlation between our catalog circulation and net revenues, or if our catalog circulation optimization strategy is not successful, our results of operations could be negatively impacted.

Competition in the home furnishings sector of the retail market may adversely affect our future financial performance.

The home furnishings sector within the retail market is highly competitive. We compete with the interior design trade and specialty stores, as well as antique dealers and other merchants that provide unique items and custom-designed product offerings at higher price points. We also compete with national and regional home furnishing retailers and department stores. In addition, we compete with mail order catalogs and online retailers focused on home furnishings.

We compete generally with these other retailers for customers, suitable retail locations, vendors, qualified employees and management personnel. As we have traditionally been a leader in the home furnishings sector, some of our competitors have also attempted to imitate our product offerings and business initiatives from time to time in the past. However, many of our competitors have significantly greater financial, marketing and other resources than we do and therefore may be able to devote greater resources to the marketing and sale of their products, generate greater national brand recognition or adopt more aggressive pricing policies than we can. In addition, such competitors may also be able to adapt to changes in customer preferences more quickly than we can due to their greater financial or marketing resources. Further, increased catalog mailings by our competitors may adversely affect response rates to our own Source Book mailings. There can be no assurance that such competitors will not be more successful than us, based on

imitation or otherwise, or that we will be able to continue to maintain a leadership position in style and innovation in the future.

Increased competition also has resulted, and may in the future result, in potential or actual litigation between us and our competitors related to a variety of activities, including hiring practices. If we are not successful in such litigation, our business could be harmed.

If we fail to successfully anticipate consumer preferences and demand our results of operations may be adversely affected.

We are vulnerable to customer preferences and demand. Our success depends in large part on our ability to originate and define home product trends, as well as to anticipate, gauge and react to changing consumer demands in a timely manner. Our products must appeal to a range of consumers whose preferences cannot always be predicted with certainty. We cannot assure you that we will be able to continue to develop products that customers positively respond to or that we will successfully meet consumer demands in the future. Any failure on our part to anticipate, identify or respond effectively to consumer preferences and demand could adversely affect sales of our products, which could have a material adverse effect on our financial condition and results of operations.

If we fail to successfully and timely deliver merchandise to our customers and manage our supply chain commensurate with demand, our results of operations may be adversely affected.

We must successfully manage our supply chain and vendors in order to produce sufficient quantities of products that our customers wish to purchase in a timely manner. We must manage our supply chain and inventory levels, including predicting the appropriate levels and type of inventory to stock within each of our distribution centers, such that our “in stock” position in merchandise correlate well to consumer demand and expected delivery times. Because much of our merchandise requires that we provide vendors with significant ordering lead times, frequently before market factors are known, we may not be able to source sufficient inventory to meet demand if our products prove more popular than anticipated. From time to time, we have experienced periods in which some of our vendors were not able to meet customer demand levels for certain products resulting in significant back orders for goods, higher rates of cancellation on orders in process and, in some instances, the loss of customer sales when orders could not be completed in a timely manner. Further, the seasonal nature of some of our products requires us to carry a significant amount of inventory prior to certain selling seasons. If we are unable to accurately predict and track demand, we may be required to mark down the price of certain products in order to sell excess inventory or we may be required to sell such inventory through our outlet stores or warehouse sales. For these reasons, our results of operations in any given quarterly period may be adversely affected. We expect these factors to continue from time to time as we add new product assortments and new merchandise categories into our business.

We are subject to risks associated with our dependence on foreign manufacturing and imports for our merchandise.

Based on total volume dollar purchases, in fiscal 2015 we sourced approximately 89% of our merchandise from outside the United States, including 82% from Asia, the majority of which originated from China. In addition, some of the merchandise we purchase from vendors in the United States also depends, in whole or in part, on vendors located outside the United States. As a result, our business highly depends on global trade, as well as trade and cost factors that impact the specific countries where our vendors are located, particularly Asia. Our future success will depend in large part upon our ability to maintain our existing foreign vendor relationships and to develop new ones as well as the ability of our vendors to scale their operations commensurate with demand from our customers, which in some cases will require substantial ongoing investments to support additional capacity. While we rely on our long-term relationships with our foreign vendors, we have no long-term contracts with them and transact business on an order-by-order basis. Additionally, many of our imported products are subject to existing duties, tariffs, anti-dumping duties and quotas that may limit the quantity of some types of goods that we import into the United States.

Our dependence on foreign imports also makes us vulnerable to risks associated with products manufactured abroad, including, among other things, risks of damage, destruction or confiscation of products while in transit to our distribution centers located in the United States, charges on or assessment of additional import duties, tariffs, anti-dumping duties and quotas, loss of “most favored nation” trading status by the United States in relation to a particular foreign country, work stoppages, including without limitation as a result of events such as longshoremen strikes, transportation and other delays in shipments, including without limitation as a result of heightened security screening and inspection processes or other port-of-entry limitations or restrictions in the United States, freight cost increases, economic uncertainties, including inflation, foreign government regulations, trade restrictions, including the United States retaliating against protectionist foreign trade practices and political unrest, increased labor costs and other similar factors that might affect the operations of our vendors in specific countries such as China.

An interruption or delay in supply from our foreign sources, or the imposition of additional duties, taxes or other charges on these imports, could have a material adverse effect on our business, financial condition and results of operations unless and until alternative supply arrangements are secured.

In addition, there is a risk that compliance lapses by our vendors could occur, which could lead to investigations by U.S. government agencies responsible for international trade compliance. Any resulting penalty or enforcement action could delay future imports/exports or otherwise negatively impact our business. In addition, there can be no assurance that our vendors outside the United States will adhere to applicable legal requirements or our global compliance standards such as fair labor standards, prohibitions on child labor and other product safety or manufacturing safety standards. The violation of applicable legal requirements by any of our vendors or the failure to adhere to labor, manufacturing safety and other laws by any of our vendors, or the divergence of the labor practices followed by any of our vendors from those generally accepted in the United States, could disrupt our supply of products from our vendors or the shipment of products to us, result in potential liability to us and harm our reputation and brand and subject us to boycotts by our customers or activist groups, any of which could negatively affect our business and results of operations.

Our growth strategy and performance depend on our ability to purchase quality merchandise in sufficient quantities at competitive prices, including products that are produced by artisans and specialty vendors. Any disruptions we experience in our ability to obtain quality products in a timely fashion or in the quantities required could have a material adverse effect on our business.

We purchase substantially all of our merchandise from a number of third party vendors. Many such vendors are the sole sources for particular products, and we generally transact business with such vendors on an order-by-order basis without any long-term or other contractual assurances of continued supply, pricing or access to new products with our vendors. Therefore, we may be dependent on particular vendors that produce popular items, and any vendor could discontinue selling to us at any time. In the event that one or more of our vendors is unable or unwilling to meet the quantity or quality of our product requirements, we may not be able to develop relationships with new vendors in a manner that is sufficient to supply the shortfall. Even if we do identify such new vendors, we may experience product shortages and customer backorders as we transition our product requirements to incorporate alternative suppliers. Our relationship with any new vendor would be subject to the same or similar risks as those of our existing suppliers.

Furthermore, our growth strategy includes expanding our product assortment, and our performance depends on our ability to purchase our merchandise in sufficient quantities at competitive prices. However, many of our key products are produced by artisans, specialty vendors and other vendors that are small, undercapitalized or that may have limited production capacity, and we have from time to time in prior periods experienced supply constraints that have affected our ability to supply high demand items or new products due to such capacity and other limits in our vendor base.

A number of our vendors, particularly our artisan vendors, may have limited financial or other resources and operating histories and may receive various forms of credit from us, including with respect to payment terms or other arrangements. In some cases, we have advanced payments to vendors in order to assist a vendor in funding additional merchandise production to meet our orders. We may advance a portion of the payments to be made to some vendors under our purchase orders prior to the delivery of the ordered products. These advance payments are normally unsecured. Vendors may become insolvent and their failure to repay our advances, and any failure to deliver products to us, could have a material adverse impact on our results of operations. There can be no assurance that the capacity of any particular vendor will continue to be able to meet our supply requirements in the future, as our vendors may be susceptible to production difficulties or other factors that negatively affect the quantity or quality of their production during future periods. A disruption in the ability of our significant vendors to access liquidity could also cause serious disruptions or an overall deterioration of their businesses, which could lead to a significant reduction in their ability to manufacture or ship products to us. Any difficulties that we experience in our ability to obtain products in sufficient quality and quantity from our vendors could have a material adverse effect on our business.

Our vendors may sell similar or identical products to our competitors or on their own, which could harm our business.

Because the arrangements with our vendors are generally not exclusive, many of our vendors might be able to sell similar or identical products to our competitors. Our competitors may enter into arrangements with suppliers that could impair our ability to sell those suppliers' products, including by requiring suppliers to enter into exclusive arrangements, which could limit our ability to enter into arrangements with such suppliers or otherwise access their products. Such competitors may also purchase products in significantly greater volume than we do, which may enable them to sell the products at reduced cost or flood the market with similar products.

Our vendors could also initiate or expand sales of their products through vendor-owned stores or through the Internet to the retail market and therefore directly compete with us or sell their products through outlet centers or discount stores, increasing the competitive pricing pressure we face.

Any of the above factors could negatively affect our business and results of operations.

Defective merchandise purchased from our vendors could damage our reputation and brand image and harm our business, and we may not have adequate remedies against our vendors for defective merchandise.

We are engaged in a number of initiatives to enhance the quality of our customers' experience, which we expect will require significant expenditures in the near term and which are expected to include increasingly significant operational and other changes in the near term, such as increased attention to the quality of the products that we sell. From time to time we have recalled products from the market due to quality issues. Despite our ongoing efforts to improve customers' satisfaction with their experience at RH, we may fail to maintain the necessary level of quality for some of our products in order to satisfy our customers. For example, our vendors may not be able to continuously adhere to our quality control standards, and we might not identify a quality deficiency before merchandise ships to our stores or customers. Our failure to supply high quality merchandise in a timely and effective manner to our customers could damage our reputation and brand image, and could lead to an increase in product returns or exchanges or customer litigation against us and a corresponding increase in our routine and non-routine litigation costs. Further, any merchandise that does

not meet our quality standards or applicable government requirements could trigger high rates of customer complaints or returns or could become subject to a product recall, which could in turn damage our reputation and brand image and harm our business.

Even if we detect that merchandise is defective before such merchandise is shipped to our customers, we may not be able to return such products to the vendor, obtain a refund of our purchase price from the vendor or obtain other indemnification from the vendor. The limited capacities of certain of our vendors may constrain the ability of such vendors to replace any defective merchandise in a timely manner. Similarly, the limited capitalization and liquidity of certain of our vendors may result in such vendors being unable to refund our purchase price or pay applicable penalties or damages associated with any such defects.

Our results may be adversely affected by fluctuations in raw materials, energy costs and currency exchange rates.

Increases in the prices of the components and raw materials used in our products could negatively affect the sales of our merchandise and our product margins. Alternatively, the strength of the U.S. dollar may negatively impact the ability of some of our customers to purchase our goods. We believe some portion of our business depends on non US consumers including sales in our stores in Canada as well as sales in some of our U.S. based stores which have a high degree of visitors from other countries who purchase goods from us while visiting the United States.

Changes in prices for raw materials and fluctuations in exchange rates are dependent on a number of factors beyond our control, including macroeconomic factors which may affect commodity prices (including prices for oil, lumber and cotton); changes in supply and demand; general economic conditions; labor costs; competition; import duties, tariffs, anti-dumping duties and other similar costs; currency exchange rates and government regulation. In addition, energy costs have fluctuated dramatically in the past. Depending on the nature of changes in these different factors that affect our business, we may experience an adverse impact on our business for different reasons including increased costs of operation or lower demand for our products. We may experience slower demand from customers in markets that depend upon energy prices for a portion of their economic activity.

Changes in the value of the U.S. dollar relative to foreign currencies, including the Chinese Yuan, may increase our vendors' cost of business and ultimately our cost of goods sold and our selling, general and administrative costs. If we are unable to pass such cost increases on to our customers or the higher cost of the products results in decreased demand for our products, our results of operations would be harmed.

We are subject to risks associated with occupying substantial amounts of space, including future increases in occupancy costs. We own certain properties, and we may choose in the future to acquire further properties, including store locations, which subject us to additional risks.

We lease all but two of our retail store locations and we also lease our outlet stores, our corporate headquarters and our thirteen distribution and home delivery facilities. The initial lease term of our retail stores generally ranges from ten to fifteen years, and certain leases contain renewal options for up to twenty-five years. The initial lease term for one of our next generation Design Galleries is forty-one years, and contains renewal options for up to fourteen years. Most leases for our retail stores provide for a minimum rent, typically including escalating rent amounts, plus a percentage rent based upon sales after certain minimum thresholds are achieved, as well as common area maintenance charges, real property insurance and real estate taxes. We purchased the building and land for our store in San Francisco and one of our Toronto store locations, and we own two properties in Yountville, California, which comprise the location of our wine tasting room and which are expected to become the location of a Design Gallery in the future. We previously entered into a real estate joint venture transaction related to the development of our Patterson distribution center. As we develop new stores, new store formats and other new strategic initiatives in the future, we may explore other models for our real estate, which could include further purchases of, or joint ventures or

other forms of equity ownership in, real estate interests associated with new sites and buildings. These approaches might include complicated real estate transactions and require additional capital investment and could present different risks related to the ownership and developments of real estate compared to those risks associated with a traditional store lease with a landlord, including greater financial exposure if our plans for the relevant real estate are not as successful as we originally anticipate or if the value of the real estate we acquire subsequently decreases.

If we decide to close an existing or future store, we may nonetheless have continuing obligations with respect to that property pursuant to the applicable lease or ownership arrangements, including, among other things, paying the base rent for the balance of the lease term. Our ability to re-negotiate favorable terms on an expiring lease, to arrange for the sale of an owned property or to negotiate favorable terms for a suitable alternate location could depend on conditions in the real estate market, competition for desirable properties, our relationships with current and prospective landlords and other factors that are not within our control. Our inability to enter into new leases or renew existing leases on terms acceptable to us or be released from our obligations under leases or other obligations for stores that we close could materially adversely affect our business and results of operations.

A number of factors that affect our ability to successfully open new stores within the time frames we initially target or optimize our store footprint are beyond our control, and these factors may harm our ability to execute our strategy of sizing stores to the potential of the market, which may negatively affect our results of operations.

We are focused on sizing our assortments and our stores to the potential of the market by adjusting the square footage and number of stores on a geographic market-by-market basis. We plan to optimize our real estate by continuing to open larger square footage Galleries in key markets and relocating or closing selected stores in these or adjacent markets. When we address the introduction of new stores in a particular market or changes to, or closure of, existing stores, we must make a series of decisions regarding the size and location of new stores (or the existing stores slated to undergo changes or closure) and the impact on our other existing stores in the area or being without presence or “out of the market”.

Our ability to maximize the productivity of our retail store base, depends on many factors, including, among others, our ability to:

- identify suitable locations, the availability of which is largely outside of our control;
- size the store locations to the market opportunity;
- retain customers in a certain geographic market when we close stores in such market or an adjacent market;
- negotiate acceptable new lease terms or lease renewals, modifications or terminations;
- efficiently build and equip new stores or remodel existing locations;
- source sufficient levels of inventory to meet the needs of changes in our store footprint in a timely manner;
- successfully integrate changes in our store base into our existing operations and information technology systems;
- obtain or maintain adequate capital resources on acceptable terms;
- avoid construction or local permit delays, construction accidents and injuries and cost overruns in connection with the opening of new stores or the expansion or remodeling of existing stores;
- maintain adequate distribution facilities, information systems and other operational systems to serve our new stores and remodeled stores; and
- address competitive, merchandising, marketing, distribution and other challenges encountered in connection with expansion into new geographic areas and markets.

We have experienced delays in opening some new stores within the time frames we initially targeted, and may experience such delays again in the future. Any of the above challenges or other similar challenges could delay or prevent us from completing store openings or the additional remodeling of existing stores or hinder the operations of stores we open or remodel. If any of these challenges delays the opening of a store, our results of operations will be negatively affected as we will incur leasing and other costs during the delay without associated store revenue at such location. New or remodeled stores may also not be profitable or achieve our target return on investment. Unfavorable economic and business conditions and other events could also interfere with our plans to expand or modify store footprints. Our failure to effectively address challenges such as those listed above could adversely affect our ability to successfully open new stores or change our store footprint in a timely and cost-effective manner and could have a material adverse effect on our business, results of operations and financial condition.

Reductions in the volume of mall and other in-store traffic or the closing of shopping malls as a result of changing demographic patterns could significantly reduce our sales and leave us with unsold inventory.

A significant portion of our stores is currently located in shopping malls. Additionally, we believe that the in-store shopping experience is essential to appreciating our product offerings, which was the impetus for our next generation Design Gallery format. Sales at stores located in malls are derived, in part, from the volume of traffic in those malls. These stores benefit from the ability of the malls to generate consumer traffic in the vicinity of our stores and the continuing popularity of the malls as shopping destinations and positive experiences.

However, in recent years there has been a shift in consumer preferences to purchasing certain products online rather than in stores. This shift, particularly when coupled with past unfavorable economic conditions in certain regions, has adversely affected mall traffic in some regions and has threatened the viability of certain commercial real estate firms that operate major shopping malls. A continuation of such trend, could adversely impact the sales generated by our stores currently located in shopping malls.

If we are unable to successfully operate our distribution centers, furniture home delivery hubs and customer service centers, as well as fulfill orders and deliver our merchandise to our customers in a timely manner, our business and results of operations will be harmed.

Our business depends upon the successful operation of our distribution centers, furniture home delivery hubs and customer service centers, as well as upon our order management and fulfillment services and the re-stocking of inventories within our stores. The efficient flow of our merchandise requires that our facilities have adequate capacity to support our current level of operations and any anticipated increased levels that may follow from any growth of our business.

Due to our historical rate of growth and customer demand, we have found that our distribution centers often run at capacity, and from time to time we have opened additional distribution and home delivery facilities in an effort to improve our ability to serve our customers. We have encountered operational difficulties with respect to new facilities, such as disruptions in transitioning fulfillment orders to the new distribution facilities and problems associated with operating new facilities or reducing the size and changing functions of existing facilities. These difficulties can result in a negative experience for our customers. We also have encountered various operating difficulties with respect to fulfilling orders and delivering merchandise to our customers in a timely or efficient manner that is fully satisfactory to our customers. We are currently engaged in efforts to improve the quality of our customer experience, which includes making changes to the way in which we operate our distributions centers, furniture home delivery hubs and customer service centers. Some of these efforts may require us to make significant expenditures in periods in the near term, which may also have a negative effect on our results of operations if there is no associated increase in revenues or decrease in returns or if any such effect is less than anticipated. There can be no assurance however that any of these efforts will be successful or that we will not encounter additional difficulties in achieving higher levels of customer satisfaction.

We currently rely upon independent third-party transportation providers for the majority of our product shipments, which subjects us to certain risks.

We currently rely upon independent third-party transportation providers for product shipments from our vendors to our stores and to our customers outside of certain areas. Our utilization of third-party delivery services for shipments is subject to risks, including increases in fuel prices, which would increase our shipping costs, as well as strikes, work stoppages and inclement weather, which may impact shipping companies' abilities to provide delivery services that adequately meet our shipping needs. For example, strikes or even threat of strikes involving longshoreman and clerical workers at ports in the past few years have completely shut down such ports for periods of time, impacting retail and other industries. If we change shipping companies, we could face logistical difficulties that could adversely affect deliveries and we would incur costs and expend resources in connection with such change. Moreover, we may not be able to obtain terms as favorable as those received from the third-party transportation providers we currently use, which in turn would increase our costs.

Our operations have significant liquidity and capital requirements and depend on the availability of adequate financing on reasonable terms. If we are unable to borrow sufficient capital when needed, it could have a significant negative effect on our ability to grow our business.

We have historically relied on the availability of some amount of debt financing. Although currently there are no amounts outstanding under Restoration Hardware, Inc.'s revolving line of credit, we completed debt financings in 2014 and 2015 through the issuance of two series of convertible senior notes for an aggregate principal amount of \$650 million. As a result of the availability under our revolving line of credit and the proceeds we received from our convertible senior note financings, we currently have sufficient capital for the operation of our business in the near term.

On the other hand, we may expend some significant portion of our capital on investments in our business or the acquisition of other businesses or on other growth initiatives. In addition, our capital needs may change in the future due to changes in our business or new opportunities that we choose to pursue. We have invested significant capital expenditures in remodeling and opening new Galleries, and these capital expenditures have increased and will continue to increase in fiscal 2016 with potential increases in successive future periods as we open additional next generation Design Galleries, which may require us to undertake upgrades to historical buildings or construction of new buildings.

During fiscal 2015, we spent \$133.5 million for capital expenditures, including the acquisition of buildings and land. Additionally, we made payments of \$20.0 million in fiscal 2015 to escrow accounts for future construction of next generation Design Galleries. We anticipate our gross capital expenditures to be approximately \$175 million to \$200 million for fiscal 2016. We plan to continue our growth and expansion, including opening next generation Design Galleries in select major metropolitan markets, pursuing category extensions of our brand, and exploring new business areas. We own the building and land for our Gallery in San Francisco and for one of our Toronto Galleries, as well as the location of our wine tasting room in Yountville, California, which is expected to be the location of a Design Gallery in the future, but to date we have principally relied upon leases with landlords for our

other locations. As we develop new Galleries, as well as potentially other strategic initiatives, in the future, we may explore other models for our real estate, which could include further purchases of, or joint ventures or other forms of equity ownership in, real estate interests associated with new sites and buildings. These approaches might require greater capital investment than a traditional store lease with a landlord.

In certain circumstances, we may be required to repay the two series of convertible senior notes that we issued in 2014 and 2015 with cash payments. See Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Convertible Senior Notes. Additionally, at the time the notes become due, the trading price of our common stock may be such that we may find it necessary to settle the notes in cash.

There can be no assurance that we will have sufficient financial resources, or will be able to arrange financing, to pay the amount of cash due if holders surrender their notes for conversion. In addition, agreements governing any debt may restrict our ability to make each of the required cash payments even if we have sufficient funds to make them. Furthermore, our ability to purchase the notes or to pay cash upon the conversion of the notes may be limited by law or regulatory authority. In addition, if we fail to purchase the notes, to pay special interest, if any, due on the notes, or to pay the amount of cash due upon conversion, we will be in default under the respective indentures governing the notes, which in turn may result in the acceleration of other indebtedness we may then have. If the repayment of the other indebtedness were to be accelerated, we may not have sufficient funds to repay that indebtedness and to purchase the notes or to pay the amount of cash due upon conversion.

The need to repay such convertible senior notes could cause us to incur additional borrowings or the sale of additional notes to investors. We may also experience cash flow shortfalls in the future, and we may otherwise require additional external funding, or we may need to raise funds to take advantage of unanticipated opportunities, to make acquisitions of other businesses or companies or to respond to changing business conditions or unanticipated competitive pressures. Any weakening of, or other adverse developments in, the U.S. or global credit markets could affect our ability to manage our debt obligations and our ability to access future debt. We cannot assure you that we will be able to raise necessary funds on favorable terms, if at all, or that future financing requirements would not be dilutive to holders of our capital stock. If we fail to raise sufficient additional funds, we may be required to delay or abandon some of our planned future expenditures or aspects of our current operations.

If we lose key personnel or are unable to hire additional qualified personnel, our business may be harmed.

The success of our business depends upon the continued service of our key personnel, including our Chairman and Chief Executive Officer, Gary Friedman, as well as other members of our senior management responsible for merchandise assortment and other business operations. The loss of the services of our key personnel could make it more difficult to successfully operate our business and achieve our business goals. Our key officers and directors periodically travel together while on company business. We do not have a policy that prohibits key officers and directors from flying together, whether flying commercially or in our corporate aircraft. In addition, we do not maintain key man life insurance policies on any of our key personnel. As a result, we may not be able to cover the financial loss we may incur in losing the services of any of our key personnel.

Competition for qualified employees and personnel in the retail industry is intense, particularly in the San Francisco Bay Area where our headquarters are located, and we may be unable to retain personnel that are important to our business or hire additional qualified personnel. The process of identifying personnel with the combination of skills and attributes required to carry out our goals is often lengthy. Our success depends to a significant degree upon our ability to attract, retain and motivate qualified management, marketing and sales personnel, and store managers, and upon the continued contributions of these people. We cannot assure you that we will be successful in attracting and retaining qualified executives and personnel.

In addition, our success depends in part upon our ability to attract, motivate and retain a sufficient number of store employees who understand and appreciate our corporate culture and customers. Turnover in the retail industry is generally high. Excessive store employee turnover will result in higher employee costs associated with finding, hiring and training new store employees. If we are unable to hire and retain store personnel capable of consistently providing a high level of customer service, our ability to open new stores may be impaired, the performance of our existing and new stores could be materially adversely affected and our brand image may be negatively impacted.

Material damage to, or interruptions in, our information systems as a result of external factors, staffing shortages and difficulties in updating our existing software or developing or implementing new software could have a material adverse effect on our business or results of operations, and we may be exposed to risks and costs associated with protecting the integrity and security of our customers' information.

We depend largely upon our information technology systems in the conduct of all aspects of our operations, many of which we have only adopted and implemented within the past several years or are in the midst of implementing in connection with rebuilding our supply chain and infrastructure. Additionally, in light of the various initiatives in which we are engaged in order to improve customer satisfaction, we are evaluating further new systems to enhance customer service. Such systems are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, security breaches and natural disasters. Damage or interruption to our information systems may require a significant investment to fix or replace the affected system, and we may suffer interruptions in our operations in the interim. Management information system failures or telecommunications system problems may disrupt operations. In addition, costs and potential problems and interruptions associated with the implementation of new or upgraded systems and technology or with maintenance or adequate support of existing systems could also disrupt or reduce the efficiency of our operations. Any material interruptions or failures in our systems may have a material adverse effect on our business or results of operations.

Additionally, a significant number of customer purchases across all of our channels are made using credit cards, and a significant number of our customer orders are placed through our websites. We process, store, and transmit large amounts of data, including personal information, for our customers. Also, we depend in part throughout our operations on the secure transmission of confidential information over public networks. In addition, security breaches can also occur as a result of non-technical issues, including vandalism, catastrophic events, and human error. Our information systems, however, are subject to the above delineated risks. Our operations may further be impacted by security breaches that occur at third party vendors.

In order for our business to function successfully, we and other market participants must be able to handle and transmit confidential and personal information securely. That data may include data about our customers, including credit card information. From time to time, we may implement strategic initiatives related to elevating our customer service experience such as customer membership programs where we collect and maintain increasing amounts of customer data. We also handle and transmit sensitive information about our vendors and workforce, including social security numbers and bank account information.

We cannot provide assurance that our measures, however reasonable, to secure credit card information and other personal data to meet current and evolving industry security standards, including Payment Card Industry (PCI) Standards, the standards that protect credit card data. There can be no assurance that we will be able to operate our facilities and our customer service and sales operations in accordance with or in continued compliance with Payment Card Industry, or PCI, Data Security Standards or other industry recommended practices. We expect to incur expenses to maintain compliance with applicable industry standards and practices. Given the challenges of keeping networks and systems secure and the evolving nature of the standards, we cannot provide absolute assurance of our ability to maintain and achieve compliance with future security standards or that meeting those standards will in fact prevent a data breach.

Further, there is increased litigation over personally identifiable information and other data breaches and we may be subject to one or more claims or lawsuits related to the intentional or unintentional release of confidential or personal information, including personally identifiable information about our customers, vendors or workforce.

Any breach could cause consumers to lose confidence in the security of our website and choose not to purchase from us. If a computer hacker or other third party is able to circumvent our security measures, he or she could destroy or

steal valuable information or disrupt our operations. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any security breach could expose us to risks of data loss, fines, litigation and liability and could seriously disrupt our operations and harm our reputation, any of which could adversely affect our business. In addition to the possibility of fines, lawsuits and other claims, we could be required to expend significant resources to change our business practices or modify our service offerings in connection with the protection of personally identifiable information, which could have a material adverse effect on our business.

In addition, we collect and store personal information from consumers in the course of doing business. States and the federal government have enacted additional laws and regulations to protect consumers against identity theft, including laws governing treatment of personally identifiable information. These laws have increased the costs of doing business and, if we fail to implement appropriate safeguards or we fail to detect and provide prompt notice of unauthorized access as required by some of these laws, we could be subject to potential claims for damages and other remedies. If we were required to pay any significant amount in satisfaction of claims under these laws, or if we were forced to cease our business operations for any length of time as a result of our inability to

comply fully with any such law, our business, results of operations and financial condition could be adversely affected. We may also incur legal costs if we are required to defend our methods of collection, processing and storage of personal data. Investigations, lawsuits, or adverse publicity relating to our methods of handling personal data could result in increased costs and negative market reaction.

Furthermore, data security breaches suffered by well-known companies and institutions have attracted a substantial amount of media attention, prompting additional state and federal proposals addressing data privacy and security. As the data privacy and security laws and regulations evolve, we may be subject to more extensive requirements to protect the customer information that we process in connection with the purchases of our products. Our failure to successfully respond to these risks and uncertainties could reduce website sales and have a material adverse effect on our business or results of operations.

We currently maintain insurance to protect against cybersecurity risks and incidents. However, there can be no assurance that such insurance coverage will be available in the future on commercially reasonable terms or at commercially reasonable rates. In addition, insurance coverage may be insufficient or may not cover certain cybersecurity losses and liability.

We face product liability risks and certain of our products may be subject to recalls or other actions by regulatory authorities, and any such recalls or similar actions could have a material adverse effect on our business.

We face product liability, product safety and product compliance risks relating to the design, manufacturing, raw material sourcing, testing, contents, importation, sale, use and performance of some of our products. The products we sell must be designed and manufactured to be safe for their intended purposes. Some of our products must comply with certain federal and state laws and regulations. For example, some of our products are subject to the Consumer Product Safety Act, the Federal Hazardous Substances Act and the Consumer Product Safety Improvement Act, or the “CPSIA”, which empower the Consumer Product Safety Commission, or the “CPSC”, to establish product bans, substance bans, substance limits, performance requirements, test methods and other compliance verification processes. The CPSC is empowered to take action against hazards presented by consumer products, up to and including product recalls. We are required to report certain incidents related to the safety and compliance of our products to the CPSC, and failure to do so could result in a civil penalty. The CPSC is particularly active in regulation and enforcement activities related to the kinds of children’s products sold in our RH Baby & Child division. Certain of the products we sell are subject to the Lacey Act, prohibiting the importation and sale of products containing illegally harvested wood, among other things. Likewise, many of our products are subject to the regulations of the California Air Resources Board, or the “CARB”, regarding formaldehyde emissions from composite wood products (e.g., plywood and medium density fiberboard).

If we experience negative publicity, regardless of any factual basis, customer complaints or litigation alleging illness or injury, related to our products, or if there are allegations of failure to comply with applicable regulations, our brand reputation would be harmed.

We maintain a product safety and compliance program to help ensure our products are safe, legal and made consistently in compliance with our values. Nevertheless, our products have, from time to time, been subject to recall for product safety and compliance reasons, and concerns of product safety and compliance could result in future voluntary or involuntary removal of products, product recalls, other actions by applicable government authorities or product liability, personal injury or property damage claims.

Federal, state, provincial and local legislators and regulators in the United States and Canada, where our products are sold, continue to adopt new product laws and regulations. These new laws and regulations have increased or likely will significantly increase the regulatory requirements governing the manufacture and sale of certain of our products

as well as the potential penalties for noncompliance with applicable regulations. In addition, product recalls, removal of products, product compliance enforcement actions and defending product liability claims can result in, among other things, lost sales, diverted resources, potential harm to our reputation and increased customer service costs, any of which could have a material adverse effect on our business and results of operations.

There are claims made against us and/or our management from time to time that can result in litigation or regulatory proceedings, which could distract management from our business activities and result in significant liability.

From time to time, we and/or our management are involved in litigation, claims and other proceedings relating to the conduct of our business, including purported class action litigation. Such legal proceedings may include claims related to our employment practices, claims of intellectual property infringement, including with respect to trademarks and trade dress, claims asserting unfair competition and unfair business practices, claims with respect to our collection and sale of reproduction products, and consumer class action claims relating to our consumer practices including the collection of zip code or other information from customers. In addition, from time to time, we are subject to product liability and personal injury claims for the products that we sell and the stores we operate.

Subject to certain exceptions, our purchase orders generally require the vendor to indemnify us against any product liability claims; however, if the vendor does not have insurance or becomes insolvent, we may not be indemnified. In addition, we could face a wide variety of employee claims against us, including general discrimination, privacy, labor and employment, ERISA and disability claims. Any claims could result in litigation against us and could also result in regulatory proceedings being brought against us by various federal and state agencies that regulate our business, including the United States Equal Employment Opportunity Commission. Often these cases raise complex factual and legal issues, which are subject to risks and uncertainties and which could require significant management time. Litigation and other claims and regulatory proceedings against our management or us could result in unexpected expenses and liability and could also materially adversely affect our operations and our reputation.

Intellectual property claims by third parties or our failure or inability to protect our intellectual property rights could diminish the value of our brand and weaken our competitive position.

Third parties have and may in the future assert intellectual property claims against us, particularly as we expand our business to include new products and product categories and move into other geographic markets. Our defense of any claim, regardless of its merit, could be expensive and time consuming and could divert management resources. Successful infringement claims against us could result in significant monetary liability and prevent us from selling some of our products. In addition, resolution of claims may require us to redesign our products, license rights from third parties or cease using those rights altogether, which could have a material adverse impact on our business, financial condition or results of operations.

We currently rely on a combination of copyright, trademark, patent, trade dress and unfair competition laws, as well as confidentiality procedures and licensing arrangements, to establish and protect our intellectual property rights. We believe that our trademarks and other proprietary rights have significant value and are important to identifying and differentiating certain of our products and brand from those of our competitors and creating and sustaining demand for certain of our products. We have from time to time encountered other retailers selling products substantially similar to our products or misrepresenting that the products such retailers were selling were our products. We cannot assure you that the steps taken by us to protect our intellectual property rights will be adequate to prevent infringement of our rights by others, including imitation of our products and misappropriation of our brand. The costs of defending and enforcing our intellectual property assets may incur significant time and legal expense, and we may not be entirely successful in protecting our assets and enforcing our rights. If we are unable to protect and maintain our intellectual property rights, the value of our brand could be diminished and our competitive position could suffer.

Compliance with laws, including laws relating to our business activities outside of the United States, may be costly, and changes in laws could make conducting our business more expensive or otherwise change the way we do business.

We are subject to numerous regulations, including labor and employment, customs, truth-in-advertising, consumer protection, e-commerce, privacy, safety, real estate, environmental and zoning and occupancy laws, and other laws and regulations that regulate retailers generally or govern our business. If these regulations were to change or were violated by us or our vendors or buying agents, the costs of certain goods could increase, or we could experience delays in shipments of our goods, be subject to fines or penalties, or suffer reputational harm, which could reduce demand for our products and harm our business and results of operations.

In addition to increased regulatory compliance requirements, changes in laws could make ordinary conduct of our business more expensive or require us to change the way we do business. For example, as a retail business, changes in laws related to employee benefits and treatment of employees, including laws related to limitations on employee hours, supervisory status, leaves of absence, mandated health benefits or overtime pay, could negatively impact us by increasing compensation and benefits costs for overtime and medical expenses. In addition, relatively new United

States health care laws and potential global and domestic greenhouse gas emission requirements and other environmental legislation and regulations could result in increased direct compliance costs for us (or may cause our vendors to raise the prices they charge us in order to maintain profitable operations because of increased compliance costs), increased transportation costs or reduced availability of raw materials.

In fiscal 2015 we sourced 89% of our products from outside the United States, and we are increasing the level of our international sourcing activities in an effort to obtain more of our products directly from vendors located outside the United States. Additionally, we have expanded our business-to-business sales. The foreign and U.S. laws and regulations that are applicable to our operations are complex and may increase the costs of regulatory compliance, or limit or restrict the products or services we sell or subject our business to the possibility of regulatory actions or proceedings. The United States Foreign Corrupt Practices Act, and other similar laws and regulations, generally prohibit companies and their intermediaries from making improper payments to foreign governmental officials for the purpose of obtaining or retaining business. While our policies mandate compliance with applicable laws and regulations, including anti-bribery laws and other anti-corruption laws, we cannot assure you that we will be successful in preventing our employees or other agents from taking actions in violation of these laws or regulations. Such violations, or allegations of such violations, could disrupt our business and result in a material adverse effect on our financial condition, results of operations and cash flows.

Labor organizing and other activities could negatively impact us.

Currently, none of our employees are represented by a union. However, our employees have the right at any time to form or affiliate with a union, and union organizational activities have occurred previously at our Baltimore distribution center. We cannot predict the negative effects that any future organizing activities will have on our business and operations. If we were to become subject to work stoppages, we could experience disruption in our operations and increases in our labor costs, either of which could materially adversely affect our business, financial condition or results of operations.

In addition, several of our retail stores are currently under construction. If the contractors we hire to perform the construction work do not employ union labor, our locations may be subject to picketing and other labor actions that could discourage our customers from entering our stores, which could adversely affect our business at those locations and our results of operations, including our same-store sales metrics.

Fluctuations in our tax obligations and effective tax rate and realization of our deferred tax assets, including net operating loss carryforwards, may result in volatility of our results of operations.

We are subject to income taxes in the United States and certain foreign jurisdictions. We record income tax expense based on our estimates of future payments, which include reserves for uncertain tax positions in multiple tax jurisdictions, and valuation allowances related to certain net deferred tax assets, including net operating loss carryforwards. At any one time, many tax years are subject to audit by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. Under United States federal and state income tax laws, if over a rolling three-year period, the cumulative change in our ownership exceeds 50%, our ability to utilize our net operating loss carryforwards to offset future taxable income may be limited. Changes in ownership can occur due to transactions in our stock or the issuance of additional shares of our common stock or, in certain circumstances, securities convertible into our common stock. Certain transactions we have completed, including our going private transaction in June 2008, and the sale of shares in our initial public offering may impact the timing of the utilization of our net operating loss carryforwards. Furthermore, it is possible that transactions in our stock that may not be within our control may cause us to exceed the 50% cumulative change threshold and may impose a limitation on the utilization of our net operating loss carryforwards in the future. Any such limitation on the timing of utilizing our net operating loss carryforwards would increase the use of cash to settle our tax obligations. We expect that throughout the year there could be ongoing variability in our quarterly tax rates as events occur and exposures are evaluated.

In addition, our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of earnings, timing of the utilization of net operating loss carryforwards, changes in the valuation allowance for deferred taxes or by changes to existing accounting rules or regulations. Further, tax legislation may be enacted in the future that could negatively impact our current or future tax structure and effective tax rates.

Changes to accounting rules or regulations may adversely affect our results of operations.

New accounting rules or regulations and varying interpretations of existing accounting rules or regulations have occurred and may occur in the future. A change in accounting rules or regulations may even affect our reporting of transactions completed before the change is effective, and future changes to accounting rules or regulations or the questioning of current accounting practices may adversely affect our results of operations.

Our total assets include intangible assets with an indefinite life, goodwill and trademarks, and substantial amounts of long-lived assets, principally property and equipment. Changes to estimates or projections used to assess the fair value of these assets, or results of operations that are lower than our current estimates at certain store locations, may cause

us to incur impairment charges that could adversely affect our results of operations.

Our total assets include intangible assets with an indefinite life, goodwill and trademarks, and substantial amounts of property and equipment. We make certain estimates and projections in connection with impairment analyses for these long-lived assets. We also review the carrying value of these assets for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. We will record an impairment loss when the carrying value of the underlying asset, asset group or reporting unit exceeds its fair value. These calculations require us to make a number of estimates and projections of future results. If these estimates or projections change, we may be required to record additional impairment charges on certain of these assets. If these impairment charges were significant, our results of operations would be adversely affected. In that regard, we recorded \$1.4 million of impairment charges on long-lived assets of certain underperforming stores in fiscal 2013, and we recorded charges amounting to \$3.2 million related to retail store closures in fiscal 2011. No such related charges were recorded in fiscal 2015, fiscal 2014 or fiscal 2012.

If we are unable to implement and maintain effective internal control over financial reporting in the future, the accuracy and timeliness of our financial reporting may be adversely affected.

We are subject to Section 404 of the Sarbanes-Oxley Act of 2002, as amended (the “Sarbanes-Oxley Act”), which requires us to maintain internal control over financial reporting and to report any material weaknesses in such internal control. Management has concluded that our internal control over financial reporting was effective as of January 30, 2016. However, if we identify in the future one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that our internal control over financial reporting is effective. In addition, our independent registered public accounting firm is required to attest to the effectiveness of our internal control over financial reporting. Therefore, even if our management concludes in the future that our internal control over financial reporting is effective, our independent registered public accounting firm may issue a report that is qualified if they are not satisfied with our controls or the level at which our controls are documented, designed, operated, or reviewed, or if they interpret the relevant requirements differently from us. Material weaknesses and significant deficiencies may be identified during the audit process or at other times.

Our reporting obligations as a public company place a significant strain on our management and our operational and financial resources and systems and will continue to do so for the foreseeable future. If we fail to timely achieve and maintain the adequacy of our internal control over financial reporting, we may not be able to produce reliable financial reports. Our failure to achieve and maintain effective internal control over financial reporting could prevent us from filing our periodic reports on a timely basis, which could result in the loss of investor confidence in the reliability of our financial statements, harm our business, and negatively impact the trading price of our common stock.

Our operations are subject to risks of natural disasters, acts of war, terrorism or widespread illness, any one of which could result in a business stoppage and negatively affect our results of operations.

Our business operations depend on our ability to maintain and protect our facilities, computer systems and personnel. Our operations and consumer spending may be affected by natural disasters or other similar events, including floods, hurricanes, earthquakes, widespread illness or fires. In particular, our corporate headquarters is located in Northern California, certain of our distribution centers are located in California and other parts of our operations are located in Northern and Southern California, each of which is vulnerable to the effects of disasters, including fires and earthquakes that could disrupt our operations and affect our results of operations. Many of our vendors are also located in areas that may be affected by such events. Moreover, geopolitical or public safety conditions which affect consumer behavior and spending may impact our business. Terrorist attacks in the United States or threats of terrorist attacks in the United States in the future, as well as future events occurring in response to or in connection with them, could again result in reduced levels of consumer spending. Any of these occurrences could have a significant impact on our results of operations, revenue and costs.

If we encounter difficulties associated with any of our facilities or if any of our facilities were to shut down for any reason, including as a result of a natural disaster, we could face shortages of inventory resulting in backorders, significantly higher costs and longer lead times associated with distributing our products to both our stores and online customers and the inability to process orders in a timely manner or ship goods to our customers. Further, any significant interruption in the operation of our customer service centers could also reduce our ability to receive and process orders and provide products and services to our stores and customers, which could result in lost sales, cancelled sales and a loss of loyalty to our brand and have a material adverse effect on our business, financial condition and results of operations.

Risks Related to Ownership of Our Common Stock

Our common stock price may be volatile or may decline regardless of our operating performance.

The market price for our common stock may be volatile. As a retailer, our results are significantly affected by factors outside our control, particularly consumer spending and consumer confidence, which can significantly affect our stock price. In addition, the market price of our common stock may fluctuate significantly in response to a number of other factors, including those described elsewhere in this “Risk Factors” section, as well as the following:

- quarterly variations in our results of operations compared to market expectations;
- changes in preferences of our customers;
- announcements of new products or significant price reductions by us or our competitors;
- size of our public float;
- stock price performance of our competitors;

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- fluctuations in stock market prices and volumes;
- default on our indebtedness;
- actions by competitors or other shopping center tenants;
- changes in senior management or key personnel;
- changes in financial estimates by securities analysts or failure to meet their expectations;
- actual or anticipated negative earnings or other announcements by us or other retail companies;
- downgrades in our credit ratings or the credit ratings of our competitors;
- natural disasters or other similar events;
- issuances or expected issuances of capital stock; and
- global economic, legal and regulatory changes unrelated to our performance.

In addition, stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many retail companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were involved in securities litigation, we could incur substantial costs and our resources and the attention of management could be diverted from our business.

Substantial future sales of our common stock, or the perception in the public markets that these sales may occur, may depress our stock price.

In the future, we may also issue our securities in connection with a capital raise or acquisitions. The amount of shares of our common stock issued in connection with a capital raise or acquisition could constitute a material portion of our then-outstanding shares of our common stock, which would result in dilution.

In addition, sales of substantial amounts of our common stock in the public market, or the perception that these sales could occur, could adversely affect the price of our common stock and could impair our ability to raise capital through the sale of additional shares.

Anti-takeover provisions in our charter documents and Delaware law might discourage or delay acquisition attempts for us that you might consider favorable.

Our certificate of incorporation and bylaws contain provisions that may make the acquisition of our Company more difficult without the approval of our board of directors. These provisions:

- establish a classified board of directors so that not all members of our board of directors are elected at one time;
- authorize the issuance of undesignated preferred stock, the terms of which may be established and the shares of which may be issued without stockholder approval, and which may include super voting, special approval, dividend or other rights or preferences superior to the rights of the holders of common stock;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that our board of directors is expressly authorized to make, alter or repeal our bylaws; and
- establish advance notice requirements for nominations for elections to our board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings.

Our certificate of incorporation also contains a provision that provides us with protections similar to Section 203 of the Delaware General Corporation Law (“DGCL”), and prevents us from engaging in a business combination with a person who acquires at least 15% of our common stock for a period of three years from the date such person acquired such common stock unless board or stockholder approval is obtained prior to the acquisition, subject to certain exceptions. These anti-takeover provisions and other provisions under Delaware law could discourage, delay or prevent a transaction involving a change in control of our Company, even if doing so would benefit our stockholders. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors of your choosing and to cause us to take other corporate actions you desire.

We do not expect to pay any cash dividends for the foreseeable future.

We do not anticipate that we will pay any cash dividends on shares of our common stock for the foreseeable future. Any determination to pay dividends in the future will be at the discretion of our board of directors and will depend upon results of operations, financial condition, contractual restrictions, restrictions imposed by applicable law and other factors our board of directors deems relevant. Accordingly, realization of a gain on your investment will depend on the appreciation of the price of our common stock, which may never occur. Investors seeking cash dividends in the foreseeable future should not purchase our common stock.

We expect that our common stock may experience increased trading volatility in connection with our Convertible Notes Financings.

In June 2015, we issued \$250 million of 0.00% convertible senior notes due 2020 and, on July 2, 2015, we issued an additional \$50 million pursuant to the exercise of the over-allotment option granted to the initial purchasers as part of the June 2015 offering (collectively, the “2020 Notes”). In June 2014, we issued \$300 million of 0.00% convertible senior notes due 2019 and, on June 24, 2014, we issued an additional \$50 million pursuant to the exercise of the over-allotment option granted to the initial purchasers as part of the June 2014 offering (the “2019 Notes” and, together with the 2020 Notes, the “Notes”). In connection with each offering of the Notes, we entered into convertible note hedge transactions with certain counterparties (the “Bond Hedge”) and warrant transactions (the “Warrants” and together with the Notes and the Bond Hedge, the “Convertible Notes Financings”) with the same counterparties (the “hedge counterparties”).

We have been advised that, in connection with establishing their initial hedge positions with respect to the Bond Hedge and Warrants, the hedge counterparties and/or their affiliates would likely purchase shares of our common stock or enter into various derivative transactions with respect to our common stock concurrently with, or shortly after, the pricing of the Notes, including with certain investors in the Notes. These hedging activities could increase (or reduce the size of any decrease in) the market price of our common stock or the Notes.

In addition, we expect that many investors in, including future purchasers of, the Notes may employ, or seek to employ, a convertible arbitrage strategy with respect to the Notes. Investors would typically implement such a strategy by selling short the common stock underlying the Notes and dynamically adjusting their short position while continuing to hold the Notes. Investors may also implement this type of strategy by entering into swaps on our common stock in lieu of or in addition to short selling the common stock.

Further, investors in the Notes may periodically modify their arbitrage strategies with respect to the Notes or modify their hedge positions with respect to the Notes from time to time. The hedge counterparties and/or their respective affiliates also may periodically modify their hedge positions from time to time (and are likely to do so during the conversion period relating to any conversion of the Notes or following any repurchase of Notes by us on any fundamental repurchase date or otherwise). Such modifications may be implemented by entering into or unwinding various derivatives with respect to our common stock, and/or by purchasing or selling shares of our common stock or other securities of the Company in secondary market transactions and/or open market transactions. The effect, if any, of these transactions and activities on the market price of our common stock or the trading prices of the Notes (which could affect a noteholder’s ability to convert the Notes or the amount and value of the consideration received upon conversion of the Notes) will depend in part on market conditions and cannot be ascertained at this time. Any of these activities, however, could adversely affect the market price of our common stock.

It is not possible to predict the effect that these hedging or arbitrage strategies adopted by holders of the Notes or counterparties to the Bond Hedge and Warrants will have on the market price of our common stock. For example, the SEC and other regulatory and self-regulatory authorities have implemented various rules and taken certain actions,

and may in the future adopt additional rules and take other actions, that may impact those engaging in short selling activity involving equity securities (including our common stock). Such rules and actions include Rule 201 of SEC Regulation SHO, the adoption by the Financial Industry Regulatory Authority, Inc. of a “Limit Up-Limit Down” program, the imposition of market-wide circuit breakers that halt trading of securities for certain periods following specific market declines, and the implementation of certain regulatory reforms required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Any changes in government regulations or other factors that affect the manner in which third parties can engage in hedging strategies, including entering into short sales or swaps on our common stock, could adversely affect the trading prices and the liquidity of the Notes and/or our common stock.

Taken together, the Bond Hedge and Warrants are intended, but not guaranteed, to offset any actual earnings dilution that could occur upon delivery of shares of common stock to satisfy to our conversion obligation under the Notes. For the 2020 Notes, the corresponding Bond Hedge and Warrants are intended to limit the earnings dilution that our stockholders would experience until the Company’s common stock is above approximately \$189.00 per share, the strike price of the 2020 Notes warrant transactions, which represented a 100% premium over the closing price of our common stock at the time we entered into the Bond Hedge and Warrants

related to the 2020 Notes. For the 2019 Notes, the corresponding Bond Hedge and Warrants are intended to limit the earnings dilution that our stockholders would experience until the Company's common stock is above approximately \$171.98 per share, the strike price of the 2019 Notes warrant transactions, which represented a 100% premium over the closing price of our common stock at the time we entered into the Bond Hedge and Warrants related to the 2019 Notes. However, these transactions are complex, and there can be no assurance that they will operate as planned.

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the price of our common stock. In addition, we do not make any representation that the counterparties to those transactions will engage in these transactions or activities or that these transactions and activities, once commenced, will not be discontinued without notice; the counterparties or their affiliates may choose to engage in, or discontinue engaging in, any of these transactions or activities with or without notice at any time, and their decisions will be in their sole discretion and not within our control.

We may issue additional shares of our common stock or instruments convertible into shares of our common stock, including in connection with the conversion of the Notes, and thereby materially and adversely affect the market price of our common stock and the trading prices of the Notes.

We are not restricted from issuing additional shares of our common stock or other instruments convertible into, or exchangeable or exercisable for, shares of our common stock during the life of each of the Notes. If we issue additional shares of our common stock or instruments convertible into shares of our common stock, it may materially and adversely affect the market price of our common stock and, in turn, the trading prices of the Notes. In addition, the conversion of some or all of the Notes may dilute the ownership interests of existing holders of our common stock, and any sales in the public market of any shares of our common stock issuable upon such conversion of the Notes could adversely affect prevailing market prices of our common stock. In addition, the anticipated conversion of the Notes could depress the market price of our common stock.

The fundamental change provisions of the Notes and the terms of the Bond Hedge and Warrants may delay or hinder an otherwise beneficial takeover attempt of us.

The fundamental change purchase rights allow holders of Notes to require us to purchase all or a portion of their Notes upon the occurrence of a fundamental change. The provisions of the indenture governing the Notes requiring an increase to the conversion rate for conversions in connection with a make-whole fundamental change, including certain corporate transactions such as a change in control, may result in a change in the value of the Notes. Additionally, upon certain change of control transactions, the offsetting Bond Hedge and Warrants that we entered into at the time we issued the Notes may be exercised and/or terminated early. As a result of these provisions, we may be required to make payments to, or renegotiate terms with, holders of the Notes and/or the hedge counterparties.

These features of the Notes and the Bond Hedge and Warrants, including the financial implications of any renegotiation of the above-mentioned provisions, could have the effect of delaying or preventing a change of control, whether or not it is desired by, or beneficial to, our stockholders, and may result in the acquisition of us being on terms less favorable to our stockholders than it would otherwise be, or could require us to pay a portion of the consideration available in such a transaction to holders of the Notes or Warrants or the counterparties to the Bond Hedge.

We are required to comply with the New York Stock Exchange ("NYSE") listing requirements, including its independence requirements. Failure by us to comply with the NYSE listing requirements could result in us receiving a deficiency or delisting notice from the NYSE.

We are required to comply with the NYSE listing requirements, including its requirement that the board of directors of a listed company be comprised of a majority of independent directors. While we are currently in compliance with this requirement, we may in the future temporarily fail to comply with it due to factors that are outside of our control. Failure by us to comply with the NYSE listing requirements could result in us receiving a deficiency or delisting notice from the NYSE.

On November 12, 2014, we notified the New York Stock Exchange (the “NYSE”) that, due to the resignation of an independent director from our board of directors effective November 7, 2014, we had only four independent directors serving on our then eight-member board of directors. Accordingly, effective November 7, 2014, our board of directors did not satisfy Section 303A.01 of the NYSE Listed Company Manual, which requires that the board of directors of a listed company be comprised of a majority of independent directors. Our board of directors subsequently appointed a new independent director effective January 22, 2015 and we have regained compliance with Section 303A.01 of the NYSE Listed Company Manual.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We leased approximately 1,400,000 leased gross square feet for 51 legacy Galleries, 6 larger format Design Galleries, 4 next generation Design Galleries, 1 RH Modern Gallery, 5 RH Baby & Child Galleries and 17 outlet stores that were open as of January 30, 2016. The initial lease term of our retail galleries generally ranges from 10 to 15 years, and certain leases contain renewal options for up to an additional 25 years.

Most leases for our retail galleries provide for a minimum rent, typically including escalating rent increases. In addition, certain leases have a percentage rent based upon sales after minimum thresholds are achieved. Leases generally require us to pay insurance, utilities, real estate taxes, repair and maintenance expenses, and common area maintenance.

Leased Properties

The following table summarizes the location and size of our leased distribution centers and corporate facilities occupied as of January 30, 2016:

Location	Purpose	Lease Expiration (Approximate)	Occupied Square Footage
Supply Chain			
Patterson, California	Distribution center	August 2030	1,501,000
West Jefferson, Ohio	Distribution center / Customer service center	April 2028	1,224,000
North East, Maryland	Distribution center	February 2028	1,195,000
Mira Loma, California	Distribution center / Home delivery / Customer service center	June 2020	886,000
Grand Prairie, Texas	Distribution center / Home delivery	August 2028	859,000
Baltimore, Maryland	Distribution center / Home delivery	June 2016	508,000
Tracy, California	Home delivery / Customer service center	September 2016	284,000
Dedham, Massachusetts	Home delivery	June 2020	119,000
Avenel, New Jersey	Home delivery	November 2016	114,000
Atlanta, Georgia	Home delivery	January 2020	101,000
Pompano Beach, Florida	Home delivery	October 2020	101,000
Houston, Texas	Home delivery	August 2018	71,000
Carmel, New York	Home delivery	January 2017	40,000
Corporate Facilities			
Corte Madera, California ⁽¹⁾	Corporate headquarters	May 2028	265,000
Richmond, California	Warehouse	September 2022	259,000
San Rafael, California	Warehouse	July 2016	10,000

Pleasanton, California	Corporate office	June 2020	8,000
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(1) Includes approximately 23,000 square feet of warehouse space.

Owned Properties

We currently own two galleries, the approximately 9,000 square foot property which is the location of our Gallery in San Francisco's Design District and the approximately 19,000 square foot property which is the location of our Gallery in Toronto, Canada.

Additionally, we own property in Yountville, California, which is the location of our wine tasting room and is expected to be the location of a Design Gallery in the future.

We believe that our current offices and facilities are in good condition, are being used productively and are adequate to meet our requirements for the foreseeable future.

Item 3. Legal Proceedings

From time to time, we and/or our management are involved in litigation, claims and other proceedings relating to the conduct of our business, including purported class action litigation. Such legal proceedings may include claims related to our employment practices, wage and hour claims, claims of intellectual property infringement, including with respect to trademarks and trade dress, claims asserting unfair competition and unfair business practices, claims with respect to our collection and sale of reproduction products, and consumer class action claims relating to our consumer practices including the collection of zip code or other information from customers. In addition, from time to time, we are subject to product liability and personal injury claims for the products that we sell and the stores we operate. Subject to certain exceptions, our purchase orders generally require the vendor to indemnify us against any product liability claims; however, if the vendor does not have insurance or becomes insolvent, we may not be indemnified. In addition, we could face a wide variety of employee claims against us, including general discrimination, privacy, labor and employment, ERISA and disability claims. Any claims could result in litigation against us and could also result in regulatory proceedings being brought against us by various federal and state agencies that regulate our business, including the U.S. Equal Employment Opportunity Commission. Often these cases raise complex factual and legal issues, which are subject to risks and uncertainties and which could require significant management time. Litigation and other claims and regulatory proceedings against us could result in unexpected expenses and liability and could also materially adversely affect our operations and our reputation.

For additional information, refer to Note 18—Commitments and Contingencies in our consolidated financial statements within Part II of this Annual Report on Form 10-K.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market For Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information and Dividend Policy

Our common stock trades under the symbol “RH” on the NYSE. The following table sets forth the highest and lowest closing prices for our common stock on the NYSE for the periods indicated.

	Highest	Lowest
Fiscal 2014		
First Quarter	\$75.16	\$54.85
Second Quarter	\$93.05	\$61.30
Third Quarter	\$88.46	\$72.63
Fourth Quarter	\$99.07	\$77.60
Fiscal 2015		
First Quarter	\$99.19	\$84.85
Second Quarter	\$105.63	\$86.93
Third Quarter	\$103.69	\$91.06
Fourth Quarter	\$105.64	\$60.22

The number of stockholders of record of our common stock as of January 30, 2016 was 51. This number excludes stockholders whose stock is held in nominee or street name by brokers.

No dividends have been declared or paid on our common stock. We do not currently anticipate that we will pay any cash dividends on our common stock in the foreseeable future.

Stock Performance Graph

This performance graph shall not be deemed “soliciting material” or to be “filed” with the SEC for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of Restoration Hardware Holdings, Inc. under the Securities Act of 1933, as amended, or the Exchange Act.

The following graph and table compare the cumulative total stockholder return for our common stock during the period from November 2, 2012 (the date our common stock commenced trading on the NYSE) through January 30, 2016 in comparison to the NYSE Composite Index and the S&P Retailing Select Index, our peer group index. The graph and the table below assume that \$100 was invested at the market close on November 2, 2012 in the common stock of Restoration Hardware Holdings, Inc., the NYSE Composite Index and the S&P Retailing Select Index. Data for the NYSE Composite Index and the S&P Retailing Select Index assumes reinvestments of dividends. The comparisons in the graph and table are required by the SEC and are not intended to be indicative of possible future performance of our common stock.

	11/2/2012	2/1/2013	8/2/2013	1/31/2014	8/1/2014	1/30/2015	7/31/2015	1/29/2016
Restoration Hardware Holdings, Inc.	100.00	116.50	221.41	182.44	264.12	281.45	326.24	198.14
NYSE Composite Index	100.00	108.87	117.67	121.04	129.84	127.96	132.15	116.97
S&P Retailing Select Index	100.00	107.88	133.46	128.22	134.63	149.53	158.69	132.53

Repurchases of Common Stock during the Three Months Ended January 30, 2016

During the three months ended January 30, 2016, we repurchased the following shares of our common stock:

	Average Purchase Number of Shares	Price Per Share
November 1, 2015 to November 28, 2015		
No activity	—	\$ —
November 29, 2015 to January 2, 2016		
Shares withheld from delivery ⁽¹⁾	9,069	80.69
January 3, 2016 to January 30, 2016		
No activity	—	—
Total	9,069	\$ 80.69

(1) Reflects shares withheld from delivery to satisfy exercise price and tax withholding obligations of employee recipients that occur upon the exercise of stock options and vesting of restricted stock units granted under the Company's 2012 Stock Incentive Plan.

Item 6. Selected Consolidated Financial Data

The following tables present Restoration Hardware Holdings, Inc.'s consolidated financial and operating data as of the dates and for the periods indicated.

Restoration Hardware Holdings, Inc. was formed as a Delaware corporation on August 18, 2011. On November 7, 2012, Restoration Hardware Holdings, Inc. completed an initial public offering and acquired all of the outstanding shares of capital stock of Restoration Hardware, Inc. In connection with the initial public offering, common stock of Restoration Hardware Holdings, Inc. was issued in replacement of prior unit awards under the Team Resto Ownership Plan. These transactions are referred to as the "Reorganization." Prior to the Reorganization, Restoration Hardware Holdings, Inc. did not engage in any business or other activities except in connection with its formation and the Reorganization. Accordingly, all financial and other information herein relating to periods prior to the completion of the Reorganization is that of Restoration Hardware, Inc.

The selected consolidated financial data as of January 30, 2016 and January 31, 2015 and for the fiscal years ended January 30, 2016, January 31, 2015, and February 1, 2014, were derived from consolidated financial statements included in Item 8—Financial Statements and Supplementary Data. The selected consolidated financial data as of February 1, 2014 and as of and for the periods ended February 2, 2013 and January 28, 2012 were derived from consolidated financial statements for such years not included herein.

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The selected historical consolidated data presented below should be read in conjunction with Item 1A—Risk Factors, Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations, our consolidated financial statements and the notes to our consolidated financial statements.

	Year Ended				January	
	January 30, 2016	January 31, 2015	February 1, 2014	February 2, 2013	28, 2012	
(dollars in thousands, excluding per square foot store data)						
Statements of Operations:						
Net revenues	\$2,109,006	\$1,867,422	\$1,550,961	\$1,193,046	\$958,084	
Cost of goods sold	1,356,314	1,176,648	994,081	756,597	601,735	
Gross profit	752,692	690,774	556,880	436,449	356,349	
Selling, general and administrative expenses	567,131	525,048	502,029	505,485	329,506	
Income (loss) from operations	185,561	165,726	54,851	(69,036)	26,843	
Interest expense—net	35,677	17,551	5,733	5,776	5,134	
Income (loss) before income taxes	149,884	148,175	49,118	(74,812)	21,709	
Income tax expense (benefit) ⁽¹⁾	58,781	57,173	30,923	(62,023)	1,121	
Net income (loss)	\$91,103	\$91,002	\$18,195	\$(12,789)	\$20,588	
Weighted-average shares used in computing basic net						
income (loss) per share	40,190,448	39,457,491	38,671,564	9,428,828	468	
Basic net income (loss) per share	\$2.27	\$2.31	\$0.47	\$(1.36)	\$43,991	
Weighted-average shares used in computing diluted net						
income (loss) per share	42,256,559	41,378,210	40,416,630	9,428,828	468	
Diluted net income (loss) per share	\$2.16	\$2.20	\$0.45	\$(1.36)	\$43,991	
Other Financial and Operating Data:						
Direct as a percentage of net revenues ⁽²⁾	49	% 50	% 47	% 46	% 44	%
Growth in net revenues:						
Stores ⁽³⁾	16	% 14	% 27	% 20	% 22	%
Direct	10	% 28	% 33	% 30	% 27	%
Total	13	% 20	% 30	% 25	% 24	%
Comparable brand revenue growth ⁽⁴⁾	11	% 20	% 31	% 28	% 26	%
Retail ⁽⁵⁾:						
Retail stores open at end of period	69	67	70	71	74	
Total leased square footage at end of period						
(in thousands) ⁽⁶⁾	1,011	861	798	768	808	
Total leased selling square footage at beginning of period						
(in thousands) ⁽⁷⁾	607	554	501	516	613	
Total leased selling square footage at end of period						
(in thousands) ⁽⁷⁾	725	607	554	501	516	
Weighted-average leased square footage	904	821	793	786	928	

(in thousands) ⁽⁸⁾

Weighted-average leased selling square footage

(in thousands) ⁽⁸⁾	641	572	526	508	589
Retail sales per leased selling square foot ⁽⁹⁾	\$1,463	\$1,413	\$1,386	\$1,161	\$832
Capital expenditures ⁽¹⁰⁾	\$133,460	\$110,359	\$93,868	\$49,058	\$25,593
Adjusted net income ⁽¹¹⁾	\$114,772	\$97,636	\$69,101	\$37,739	\$26,451

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	January 30, 2016	January 31, 2015	February 1, 2014	February 2, 2013	January 28, 2012
(in thousands)					
Balance Sheet Data:					
Cash and cash equivalents	\$349,897	\$148,934	\$13,389	\$8,354	\$8,512
Short-term and long-term investments ⁽¹²⁾	152,855	80,506	—	—	—
Working capital (excluding cash and cash equivalents) ⁽¹³⁾	511,407	391,365	263,530	230,899	156,506
Total assets	2,088,472	1,525,999	1,025,103	789,613	586,810
Convertible senior notes due 2019— ⁽¹⁴⁾	300,711	287,487	—	—	—
Convertible senior notes due 2020— ⁽¹⁴⁾	224,887	—	—	—	—
Revolving line of credit	—	—	85,425	82,501	107,502
Term loan	—	—	—	—	14,798
Financing obligations under build-to-suit lease transactions	146,621	124,770	33,165	—	—
Notes payable for share repurchases	19,523	19,285	2,710	—	—
Total debt (including current portion) ⁽¹⁵⁾	552,702	314,514	90,331	87,029	131,040
Total stockholders' equity	886,160	702,916	545,272	451,611	250,463

(1) As of the end of fiscal 2012, our U.S. operations achieved a position of cumulative profits (adjusted for permanent differences) for the most recent three-year period. We concluded that this record of cumulative profitability in recent years, coupled with our business plan for profitability in future periods, provided assurance that our future tax benefits more likely than not would be realized. Accordingly, in the year ended February 2, 2013, we released all of our U.S. valuation allowance of \$57.2 million against net deferred tax assets.

(2) Direct revenues include sales through our Source Books and websites.

(3) Stores data represents retail stores plus outlet stores.

(4) Comparable brand revenue growth includes retail comparable store sales, including RH Baby & Child and RH Modern Galleries, and direct net revenues. Comparable brand revenue growth excludes retail non-comparable store sales, closed store sales and outlet store net revenues. Comparable store sales have been calculated based upon retail stores, excluding outlet stores, that were open at least fourteen full months as of the end of the reporting period and did not change square footage by more than 20% between periods. If a store is closed for seven days during a month, that month will be excluded from comparable store sales. Because fiscal 2012 was a 53-week year, comparable brand revenue growth percentage for fiscal 2012 excludes the extra week of revenue.

(5) Retail data has been calculated based upon retail stores, which includes our RH Baby & Child and RH Modern Galleries and excludes outlet stores.

(6) Total leased square footage for fiscal 2011 through fiscal 2014 includes approximately 5,000 square feet related to one owned store location. Total leased square footage for fiscal 2015 includes approximately 24,000 square feet related to two owned store locations.

(7) Leased selling square footage is retail space at our stores used to sell our products. Leased selling square footage excludes backrooms at retail stores used for storage, office space or similar matters, as well as exterior sales space located outside a store, such as courtyards, gardens and rooftops. Leased selling square footage for fiscal 2011 through fiscal 2014 includes approximately 5,000 square feet related to one owned store location. Leased selling square footage for fiscal 2015 includes approximately 13,000 square feet related to two owned store locations.

(8)

Weighted-average leased selling and total square footage is calculated based on the number of days a gallery location was opened during the period divided by the total number of days in the period.

- (9) Retail sales per leased selling square foot is calculated by dividing total net revenues for all retail stores, comparable and non-comparable, by the weighted-average leased selling square footage for the period.
- (10) Capital expenditures include the acquisition of buildings and land. Additionally, during fiscal 2015 and fiscal 2014 we made payments of \$20.0 million and \$9.3 million, respectively, to escrow accounts for future construction of next generation Design Galleries.
- (11) Adjusted net income is a supplemental measure of financial performance that is not required by, or presented in accordance with, generally accepted accounting principles (“GAAP”). We define adjusted net income as net income (loss), adjusted for the impact of certain non-recurring and other items that we do not consider representative of our ongoing operating performance. Adjusted net income is included in this filing because management believes that adjusted net income provides meaningful supplemental information for investors regarding the performance of our business and facilitates a meaningful evaluation of actual results on a comparable basis with historical results. Our management uses this non-GAAP financial measure in order to have comparable financial results to analyze changes in our underlying business from quarter to quarter. The following table presents a reconciliation of net income (loss), the most directly comparable GAAP financial measure, to adjusted net income for the periods indicated below.

	Year Ended				
	January 30, 2016	January 31, 2015	February 1, 2014	February 2, 2013	January 28, 2012
	(in thousands)				
Net income (loss)	\$91,103	\$91,002	\$18,195	\$(12,789)	\$20,588
Adjustments pre-tax:					
Legal claim ^(a)	19,046	7,700	—	—	—
Amortization of debt discount ^(b)	19,803	6,852	—	—	—
Management and pre-IPO board fees ^(c)	—	—	—	4,258	10,715
Non-cash and other one-time compensation ^(d)	—	—	63,155	115,055	6,350
Terminated operations ^(e)	—	—	—	—	1,580
Severance and other transaction costs ^(f)	—	—	—	—	621
Lease termination costs ^(g)	—	—	—	(386)	3,110
Special committee investigation and remediation ^(h)	—	—	—	4,778	—
Initial public offering costs ⁽ⁱ⁾	—	—	—	10,755	—
Anti-dumping exposure ^(j)	—	—	—	3,250	—
Follow-on offering fees ^(k)	—	—	2,895	—	—
Subtotal adjusted items	38,849	14,552	66,050	137,710	22,376
Impact of income tax items ^(l)	(15,180)	(7,918)	(15,144)	(87,182)	(16,513)
Adjusted net income	\$114,772	\$97,636	\$69,101	\$37,739	\$26,451

- (a) Represents charges incurred or the estimated cumulative impact of coupons redeemed in connection with a legal claim alleging that the Company violated California's Song-Beverly Credit Card Act of 1971 by requesting and recording ZIP codes from customers paying with credit cards. Refer to Note 18—Commitments and Contingencies in our consolidated financial statements.
- (b) Under GAAP, certain convertible debt instruments that may be settled in cash on conversion are required to be separately accounted for as liability and equity components of the instrument in a manner that reflects the issuer's non-convertible debt borrowing rate. Accordingly, in accounting for GAAP purposes for the \$350 million aggregate principal amount of convertible senior notes that were issued in June 2014 (the "2019 Notes") and for the \$300 million aggregate principal amount of convertible senior notes that were issued in June and July 2015 (the "2020 Notes"), we separated the 2019 Notes and 2020 Notes into liability (debt) and equity (conversion option) components and we are amortizing as debt discount an amount equal to the fair value of the equity components as interest expense on the 2019 Notes and 2020 Notes over their respective terms. The equity components represent the difference between the proceeds from the issuance of the 2019 Notes and 2020 Notes and the fair value of the liability components of the 2019 Notes and 2020 Notes, respectively. Amounts are presented net of interest capitalized for capital projects of \$2.3 million and \$1.1 million during fiscal 2015 and fiscal 2014, respectively.
- (c) Includes fees and expenses paid in accordance with our management services agreement with Home Holdings, as well as fees and expense reimbursements paid to our board of directors prior to the initial public offering.
- (d) Fiscal 2013 includes a \$33.7 million non-cash compensation charge related to the one-time, fully vested option granted to Mr. Friedman upon his reappointment as Chairman and Co-Chief Executive Officer in July 2013 and a \$29.5 million non-cash compensation charge related to the performance-based vesting of certain shares granted to Mr. Friedman. Fiscal 2012 includes a \$92.0 million non-cash compensation charge related to equity grants at the time of the Reorganization, as well as a non-cash compensation charge of \$23.1 million related to the performance-based vesting of certain shares granted to Mr. Alberini and Mr. Friedman. Fiscal 2011 includes a

\$6.4 million compensation charge related to the repayment of loans owed to Home Holdings by Gary Friedman, through the reclassification by Home Holdings of Mr. Friedman's Class A and Class A-1 ownership units into an equal number of Class A Prime and Class A-1 Prime ownership units. Mr. Friedman served as our Chairman and Co-Chief Executive Officer at the time of such loan repayment.

- (e) Includes costs related to the restructuring of our Shanghai office location.
- (f) Generally includes executive severance and other related costs.
- (g) Includes lease termination costs for retail stores that were closed prior to their respective lease termination dates. The lease termination amount in fiscal 2012 includes changes in estimates regarding liabilities for future lease payments for closed stores.
- (h) Represents legal and other professional fees incurred in connection with the investigation conducted by the special committee of the board of directors relating to our Chief Executive Officer, Gary Friedman, and our subsequent remedial actions.

- (i) Represents costs incurred in connection with our initial public offering, including a fee of \$7.0 million to Catterton Management Company, LLC, Tower Three Partners LLC and GJK Capital Advisors, LLC in accordance with our management services agreement, payments of \$2.2 million to certain former executives and bonus payments to employees of \$1.3 million.
- (j) Represents expense incurred as a result of increased tariff obligations of one of our foreign suppliers following the U.S. Department of Commerce's review of the anti-dumping duty order on wooden bedroom furniture from China for the period from January 1, 2011 through December 31, 2011.
- (k) Represents legal and other professional fees incurred in connection with our follow-on offerings in May 2013 and July 2013.
- (l) As of the end of fiscal 2012, our U.S. operations achieved a position of cumulative profits for the most recent three-year period. We concluded that this record of cumulative profitability in recent years, coupled with our business plan for profitability in future periods provided assurance that our future tax benefits more likely than not would be realized. Accordingly, in fiscal 2012, we released all of our U.S. valuation allowance against net deferred tax assets. In addition, income tax items exclude the tax benefit related to the resolution of our Canada Revenue Agency examination in fiscal 2012, exclude the tax benefit from the utilization of federal and state net operating losses, and assume a normalized tax rate of 40% for fiscal 2011 through fiscal 2014. The adjustment for fiscal 2015 represents the tax effect of the adjusted items based on our effective tax rate of 39.2%.
- (12) As of fiscal 2015 and fiscal 2014, \$130.8 million and \$62.2 million, respectively, of our investments are due within one year. As of fiscal 2015 and fiscal 2014, \$22.1 million and \$18.3 million, respectively, of our investments are due within two years.
- (13) Working capital is defined as current assets, excluding cash and cash equivalents, less current liabilities, excluding the current portion of long-term debt. Fiscal 2014, fiscal 2013 and fiscal 2012 have been updated to reflect our working capital subsequent to the adoption of ASU 2015-17, which requires that deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. We have elected to early adopt the guidance on a retrospective basis effective with the consolidated balance sheet as of fiscal 2015. This is a change from our historical presentation whereby certain deferred tax assets and liabilities were classified as current and the remainder were classified as non-current. To conform to the current period presentation, we reclassified \$27.9 million, \$21.4 million and \$37.0 million current deferred tax assets which were previously included in current assets as of fiscal 2014, fiscal 2013 and fiscal 2012, respectively, to non-current assets on the consolidated balance sheets. To conform to the current period presentation, we reclassified \$0.1 million current deferred tax liabilities which were previously included in current liabilities as of both fiscal 2014 and fiscal 2013 to non-current liabilities on the consolidated balance sheets. We did not have any current deferred tax liabilities as of fiscal 2012. As we did not have any current deferred tax assets or liabilities as of fiscal 2011, the adoption of ASU 2015-17 did not have an impact on our working capital for this fiscal year.
- (14) Represents our obligations, net of debt discount, related to the 2019 Notes and 2020 Notes. The aggregate principal amounts due under the 2019 Notes and 2020 Notes are \$350 million and \$300 million, respectively.
- (15) Total debt (including current portion) includes the 2019 Notes and 2020 Notes, net of debt discount, revolving line of credit, term loan, notes payable for share repurchases and capital lease obligations.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations
Overview

We are a leading luxury retailer in the home furnishings marketplace. Our curated and fully-integrated assortments are presented consistently across our sales channels in sophisticated and unique lifestyle settings that we believe are on par with world-class interior designers. We offer dominant merchandise assortments across a growing number of categories, including furniture, lighting, textiles, bathware, décor, outdoor and garden, tableware, and child and teen furnishings. Our business is fully integrated across our multiple channels of distribution, consisting of our stores, Source Books and websites. We position our galleries as showrooms for our brand, while our Source Books and websites act as virtual extensions of our stores. As of January 30, 2016, we operated a total of 69 retail galleries, consisting of 53 legacy Galleries, 6 larger format Design Galleries, 4 next generation Design Galleries, 1 RH Modern Gallery and 5 RH Baby & Child Galleries, as well as 17 outlet stores, throughout the United States and Canada.

In order to drive growth across our business, we are focused on the following key strategies:

- Transform Our Real Estate Platform. We believe we have an opportunity to significantly increase our sales by transforming our real estate platform from our existing legacy retail footprint to a portfolio of next generation Design Galleries that are sized to the potential of each market and the size of our assortment. On average, our legacy retail stores display less than 10% of our current product assortment. Our next generation Design Galleries allow us to optimize our selling space by displaying a greater percentage of our merchandise assortment, as well as future product expansions and new businesses, in a highly differentiated retail setting. Based on our historical performance, when a product is presented on the selling floor, we experience an increase in sales for that product across all of our channels.
- Based on recent trends and our plans for product assortment expansion and new businesses, we are generally targeting a range of 25,000 to 60,000 leased selling square feet for new locations. Landlords are currently offering us leases that accommodate these space requirements and that have favorable terms, which are typically available only to anchor tenants. Based on our analysis, we believe we have the opportunity to operate next generation Design Galleries in 60 to 70 locations in the United States and Canada.
- Expand Our Offering and Increase Our Market Share. We believe we have a significant opportunity to increase our market share by:
 - Growing our merchandise assortment;
 - Introducing new products and categories;
 - Expanding our service offerings;
 - Exploring and testing new business opportunities complementary to our core business; and
 - Increasing brand awareness and customer loyalty through our circulation strategy, our digital marketing initiatives and our advertising and public relations activities and events.
 - Elevate the Customer Experience. We are focused on improving the end-to-end customer experience. As we have elevated our brand, especially at retail, other customer touch points also need to leapfrog forward to create a cohesive experience. This initiative will focus on everything from product quality to in-home delivery across all channels, and includes new people, processes, and systems.
- Increase Operating Margins. We have the opportunity to continue to improve our operating margins by leveraging our fixed occupancy, advertising and corporate general and administrative costs, as well as leveraging our scalable infrastructure. Key areas in which we believe we will increase operating margins include:
 - Occupancy leverage;
 - Advertising cost leverage;
 - Improved product margin and shipping efficiencies; and
 - Other selling, general and administrative expenses.
- Pursue International Expansion. We plan to strategically expand our business into select countries outside of the United States and Canada in the future. We believe that our luxury brand positioning and unique aesthetic will have

strong international appeal.

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Our fiscal 2015 results reflect the ongoing strength of our business. We have continued to increase market share, and at the same time invested in our infrastructure and supply chain to support future growth. Key financial achievements of fiscal 2015 include:

- Net revenues increased 13% to \$2,109.0 million in fiscal 2015, on top of a 20% increase in fiscal 2014 and a 30% increase in fiscal 2013.
- The fourth quarter of fiscal 2015 marked our 24th consecutive quarter of double-digit net revenue growth.

Factors Affecting Our Results of Operations

Various factors affected our results for the periods presented in this “Management’s Discussion and Analysis of Financial Condition and Results of Operations” including the following:

Overall Economic Trends. The industry in which we operate is cyclical, and consequently our revenues are affected by general economic conditions. For example, reduced consumer confidence and lower availability and higher cost of consumer credit may reduce demand for our products. We target consumers of high-end home furnishings. As a result, we believe that our sales are sensitive to a number of macroeconomic factors that influence consumer spending generally, but are particularly affected by the health of the higher end customer and demand levels from that customer demographic. While the overall home furnishings market may be influenced by factors such as employment levels, interest rates, demographics of new household formation and the affordability of homes for the first time home buyer, the higher end of the housing market may be disproportionately influenced by other factors including the number of foreign buyers in higher end real estate markets in the U.S., the number of second and third homes being bought and sold, stock market prices and the perceived prospect for capital appreciation in higher end real estate. We have experienced volatility in our sales trends related to many of these factors in the past and believe our sales may be impacted by these economic factors in future periods. For more information, see “Risk Factors—Changes in consumer spending and factors that influence spending of the specific consumers we target, including the health of the high-end housing market, may significantly impact our revenue and results of operations.”

Our Strategic Initiatives. We are in the process of implementing a number of significant business initiatives that have had and will continue to have an impact on our results of operations, including the development of our new larger format Design Galleries, which we refer to as next generation Design Galleries, in a number of new locations, the optimization of our store sizes to better fit anticipated demand in a given market, the expansion of our product categories and services and changes in the ways in which we market with our Source Books. In addition, we are in the process of implementing a number of initiatives to improve the quality of our customers’ experience, which includes vendor product initiatives and changes to the way we operate our distribution centers, home delivery hubs and customer service centers.

Although these initiatives are designed to create growth in our business and continuing improvement in our results of operations, the timing of expenditures related to these initiatives, as well as the achievement of returns on our investments, may affect our results of operation in future periods, and we may not achieve the desired benefits. Opening next generation Design Galleries will require significant capital expenditures, and retail store closures may lead to charges including lease termination and other exit costs. These changes could affect our results of operation in future periods. In addition, the investments required to continue our strategic initiatives may have a negative impact on cash flows in future periods and could create pressure on our liquidity if we do not achieve the desired results from these initiatives in a timely manner.

For January 30, 2016, we incurred total capital expenditures, including the acquisition of buildings and land, of \$133.5 million and we made payments of \$20.0 million in fiscal 2015 to escrow accounts for future construction of next generation Design Galleries. As an offset to gross capital expenditures in fiscal 2015 we received \$9.2 million related to profit participation arrangements for our distribution center facilities. We expect that we will continue to

incur significant capital expenditures as part of our initiative to open more next generation Design Galleries over the next several years and that these expenditures will have an impact on our cash flows during this time. We anticipate our gross capital expenditures to be approximately \$175 million to \$200 million for fiscal 2016.

Consumer Preferences and Demand. Our ability to maintain our appeal to existing customers and attract new customers depends on our ability to originate, develop and offer a compelling product assortment responsive to customer preferences and design trends. We have successfully introduced a large number of new products during recent periods, which we believe has been a contributing factor in our sales and results of operations. Periods in which our products have achieved strong customer acceptance generally have had more favorable results. If we misjudge the market for our products, we may be faced with excess inventories for some products and may be required to become more promotional in our selling activities, which would impact our net revenues and gross profit.

Our Ability to Source and Distribute Products Effectively. Our net revenues and gross profit are affected by our ability to purchase our merchandise in sufficient quantities at competitive prices. Our current and anticipated demand, our level of net revenues have been adversely affected in prior periods by constraints in our supply chain, including the inability of our vendors to produce

sufficient quantities of some merchandise in a manner that was able to match market demand from our customers, leading to higher levels of customer back orders and lost sales. For example, some of our vendors experienced difficulty in producing goods in sufficient quantity to meet initial customer demand in connection with the introduction of our RH Modern product assortment.

Fluctuation in Quarterly Results. Our quarterly results have historically varied depending upon a variety of factors, including the timing and extent of product offerings, promotional events, store openings, shifts in the timing of holidays and the timing and circulation of our Source Books, among other things. As a result of these factors, our working capital requirements and demands on our product distribution and delivery network may fluctuate during the year. Unique factors in any given quarter may affect period-to-period comparisons between the quarters being compared, and the results for any quarter are not necessarily indicative of the results that we may achieve for a full fiscal year.

In 2015, more than half of our product newness, whether within existing product categories or through creation of new product categories, was introduced in the fall of 2015, primarily with the launch of RH Modern and RH Teen, whereas in prior years the majority of our new product introductions coincided with our Spring Source Book mailing. While our Spring 2015 Source Book was mailed several weeks earlier than last year, the amount of new product introductions this Spring was lower than last year. In addition, there was a significant reduction in the circulated pages in our Spring 2015 Source Book versus last year. The timing and cadence of new product introductions is an important factor when comparing quarter and year over year results.

As a result of the number of current business initiatives we are pursuing, we have experienced in the past and may experience in the future significant period-to-period variability in our financial performance and results of operations. In response to some of our new business initiatives, we have recently experienced substantial increases in revenue and strong improvements in financial performance on a quarter by quarter comparison basis. The rate of growth in our revenue and the extent of improvements in our financial performance have changed from quarter to quarter based upon a range of business factors. We expect fluctuations in our rate of revenue growth and in our financial performance will continue in future periods as we continue to pursue a large number of new business initiatives. In addition, we anticipate that our net revenues, adjusted net income and other performance metrics will remain variable as our business model continues to emphasize high growth and numerous, concurrent and evolving business initiatives.

How We Assess the Performance of Our Business

In assessing the performance of our business, we consider a variety of financial and operating measures that affect our results of operations, including:

Net Revenues. Net revenues reflect our sale of merchandise plus shipping and handling revenue collected from our customers, less returns and discounts. Revenues are recognized upon receipt of product by our customers.

Gross Profit. Gross profit is equal to our net revenues less cost of goods sold. Gross profit as a percentage of our net revenues is referred to as gross margin. Cost of goods sold include the direct cost of purchased merchandise; inventory shrinkage, inventory adjustments due to obsolescence, including excess and slow-moving inventory and lower of cost or market reserves; inbound freight; all freight costs to get merchandise to our stores; design, buying and allocation costs; occupancy costs related to store operations and our supply chain, such as rent and common area maintenance for our leases; depreciation and amortization of leasehold improvements, equipment and other assets in our stores and distribution centers. In addition, cost of goods sold include all logistics costs associated with shipping product to our customers, which are partially offset by shipping income collected from customers (recorded in net revenues). We expect gross profit to increase to the extent that we successfully grow our net revenues and leverage the fixed portion

of cost of goods sold.

Our gross profit can be favorably impacted by sales volume increases, as occupancy and certain other costs that are largely fixed do not necessarily increase proportionally with volume increases. Changes in the mix of our products may also impact our gross profit. We review our inventory levels on an ongoing basis in order to identify slow-moving merchandise and use product markdowns and our outlet stores to efficiently sell these products. The timing and level of markdowns are driven primarily by customer acceptance of our merchandise. The primary drivers of the costs of individual goods are raw materials costs, which fluctuate based on a number of factors beyond our control, including commodity prices, changes in supply and demand, general economic conditions, competition, import duties, tariffs and government regulation, logistics costs (which may increase in the event of, for example, expansions of or interruptions in the operation of our distribution centers, furniture home delivery hubs and customer service center or damage or interruption to our information systems) and labor costs in the countries where we source our merchandise. We place orders with merchandise vendors primarily in United States dollars and, as a result, are not exposed to significant foreign currency exchange risk.

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Our gross profit may not be comparable to other specialty retailers, as some companies may not include all or a portion of the costs related to their distribution network and store occupancy in calculating gross profit as we and many other retailers do, but instead may include them in selling, general and administrative expenses. In addition, certain of our store leases are accounted for as build-to-suit lease transactions which result in our recording a portion of our rent payments under these agreements in interest expense on the consolidated statements of income.

Selling, General and Administrative Expenses. Selling, general and administrative expenses include all operating costs not included in cost of goods sold. These expenses include all payroll and payroll related expenses, store expenses other than occupancy and expenses related to many of our operations at our corporate headquarters, including utilities, depreciation and amortization, credit card fees and marketing expense, which primarily includes Source Book production, mailing and print advertising costs. All store pre-opening costs are included in selling, general and administrative expenses and are expensed as incurred. Selling, general and administrative expenses as a percentage of net revenues are usually higher in lower-volume quarters and lower in higher-volume quarters because a significant portion of the costs is relatively fixed.

Our recent revenue growth has been accompanied by increased selling, general and administrative expenses, excluding certain one-time and non-cash items discussed in “Basis of Presentation and Results of Operations” below. The most significant components of these increases are employment costs due to company growth and expansion, an increase in professional fees and other corporate costs, an increase in corporate occupancy costs associated with our corporate office expansion and upgraded technology systems, as well as an increase in credit card fees due to increased revenues. We expect certain of these expenses to continue to increase as we continue to open new stores, develop new product categories and otherwise grow our business.

Adjusted Net Income. We believe that adjusted net income is a useful measure of operating performance, as the adjustments eliminate non-recurring and other items that are not reflective of underlying business performance, facilitate a comparison of our operating performance on a consistent basis from period-to-period and provide for a more complete understanding of factors and trends affecting our business. We also use adjusted net income as one of the primary methods for planning and forecasting overall expected performance and for evaluating on a quarterly and annual basis actual results against such expectations.

We define adjusted net income as consolidated net income, adjusted for the impact of certain non-recurring and other items that we do not consider representative of our ongoing operating performance.

Comparable Brand Revenue. We believe that comparable brand revenue is a meaningful and relevant non-GAAP metric to evaluate period-to-period changes in net revenue performance given the integrated multi-channel nature of our business, the synergies between our retail stores, websites and Source Books, and the fact that customers shop across all of these channels.

Comparable brand revenue growth includes retail comparable store sales, including RH Baby & Child and RH Modern Galleries, and direct net revenues. Comparable brand revenue growth excludes retail non-comparable store sales, closed store sales and outlet store net revenues. Comparable store sales have been calculated based upon retail stores, excluding outlet stores, that were open at least fourteen full months as of the end of the reporting period and did not change square footage by more than 20% between periods. If a store is closed for seven days during a month, that month will be excluded from comparable store sales.

As the comparable brand revenue metric includes changes in retail store net revenues (i.e. comparable store sales) on a period-to-period basis and also incorporates changes in net revenues resulting from Source Book and websites sales, we believe this metric provides better information to investors in terms of evaluating our business performance and a better basis to compare performance to that of key competitors.

Basis of Presentation and Results of Operations

The following table sets forth our consolidated statements of income and other financial and operating data.

	Year Ended		
	January 30, 2016	January 31, 2015	February 1, 2014
	(dollars in thousands, excluding per square foot store data)		
Statements of Income:			
Net revenues	\$2,109,006	\$1,867,422	\$1,550,961
Cost of goods sold	1,356,314	1,176,648	994,081
Gross profit	752,692	690,774	