

RH (RH)

\$89.11 (As of 04/02/20)

Price Target (6-12 Months): **\$76.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 04/01/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:C

Value: C

Growth: C

Momentum: F

Summary

RH reported fourth-quarter fiscal 2019 results, wherein adjusted earnings beat the Zacks Consensus Estimate but revenues missed the same. Adjusted earnings grew 27% but revenues declined 1% year over year. It ended fiscal 2019 on a strong note courtesy of its core RH business, solid performance of new galleries, along with continued expansion of RH Hospitality despite adverse macro trends and higher tariffs. However, market volatility and continued softness in the high-end housing market remain concerns. Furthermore, in view of major disruption in retail business operations due to the COVID-19 outbreak, RH has withdrawn all prior guidance pertaining to fiscal 2020. Although shares of RH have outperformed the industry in the past year, the unpredictable effects of coronavirus on consumer behavior and economic activity in general may impact growth.

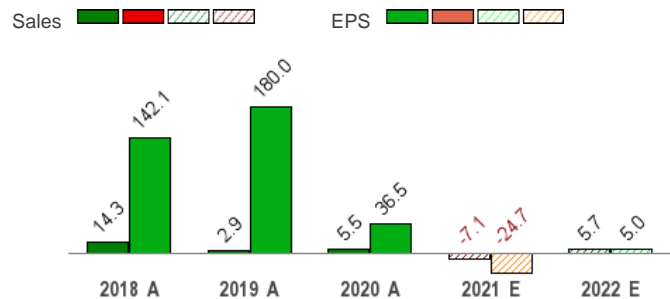
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$256.27 - \$73.14
20 Day Average Volume (sh)	2,287,593
Market Cap	\$1.7 B
YTD Price Change	-58.3%
Beta	2.23
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Retail - Home Furnishings
Zacks Industry Rank	Bottom 5% (242 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.6%
Last Sales Surprise	-6.3%
EPS F1 Est- 4 week change	-35.8%
Expected Report Date	06/10/2020
Earnings ESP	-47.4%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	451 E	593 E	701 E	740 E	2,599 E
2021	472 E	586 E	644 E	683 E	2,460 E
2020	599 A	707 A	677 A	665 A	2,647 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$1.12 E	\$2.50 E	\$2.62 E	\$3.62 E	\$9.22 E
2021	\$0.52 E	\$1.66 E	\$2.15 E	\$3.58 E	\$8.78 E
2020	\$1.85 A	\$3.20 A	\$2.79 A	\$3.72 A	\$11.66 A

*Quarterly figures may not add up to annual.

P/E TTM	7.7
P/E F1	10.2
PEG F1	0.8
P/S TTM	0.6

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/02/2020. The reports text is as of 04/03/2020.

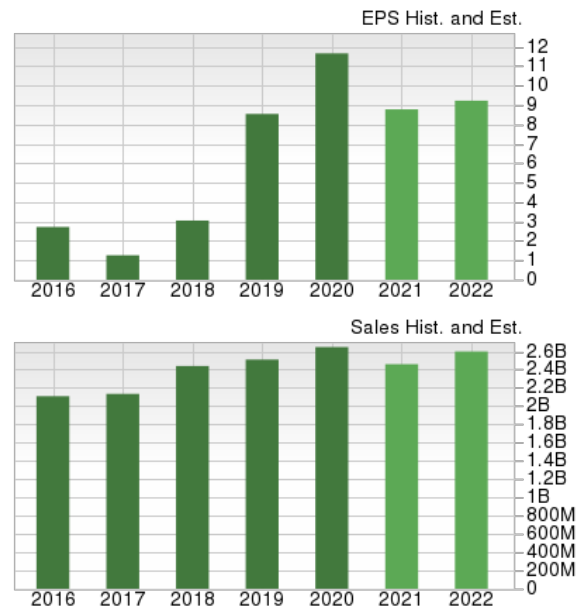
Overview

RH, formerly known as Restoration Hardware, is a leading luxury retailer in the home furnishing space. The company offers dominant merchandise assortments across a growing number of categories, including furniture, lighting, textiles, bath ware, décor, outdoor and garden, tableware, and child and teen furnishings.

RH's business is fully integrated across its multiple channels of distribution, consisting of stores, Source Books and websites.

The company operates under two segments: RH Segment (comprising 95% of fiscal 2019 net revenues) and Waterworks (5%). The segments include all sales channels accessed by the company's customers, including sales through catalogs, the company's websites, stores, and commercial channels.

As of Feb 1, 2020, RH operated a total of 68 RH Galleries and 38 RH outlet stores in 31 states, the District of Columbia and Canada, as well as 15 Waterworks showrooms throughout the United States and in the U.K., and had sourcing operations in Shanghai and Hong Kong.



Reasons To Sell:

- ▼ **Coronavirus Outbreak Hurts Near-Term Prospects:** The novel coronavirus outbreak across 192 countries and territories have led to the closure of many retail stores throughout the world. The latest U.S. retail sales data for February fell 0.5% from January, registering the largest decline since December 2018. Industry experts are concerned that there might be more hurdles in the future as consumers are restricting their buying habits to only essential items amid the life-threatening disease spread.

In view of the major disruption in financial markets and retail business operations due to the COVID-19 outbreak, RH has withdrawn all prior guidance pertaining to fiscal 2020. Additionally, the company will take more steps such as deferring new business introductions and capital spending, while reducing costs to navigate through the short-term challenges of this crisis.

Coronavirus-related woes, slowing high-end U.S. housing market, its exit from unprofitable businesses, higher tariff, and higher dependence on foreign manufacturing and imports raise concerns

- ▼ **Softness in the High-End Housing Market & Impact of Exit From Unprofitable Business:** Continued softness in the high-end housing market over the last few quarters is a cause of concern. The home furnishing industry is highly sensitive to strength of the economy.

Housing fundamentals in the United States were exceptionally strong through February 2020 before the crisis began. The picture has altered drastically since then. Most expensive housing markets in the country like New York, Seattle, San Francisco and Los Angeles are experiencing tough times due to the pandemic. This may further disrupt the demand-side scenario of the home furnishing industry.

Also, RH's ongoing exit from unprofitable and non-strategic businesses added to the woes. The company's fiscal 2019 guidance includes approximately 3 point revenue reduction as a result of exiting unprofitable and non-strategic businesses, i.e. the elimination of the remaining holiday business and fringe promotions (1 point each), as well as the transition of rug business from a single source importer to a direct sourcing model (1 point). Notably, the drag was approximately 2 points, 4 points and 2 points in the fiscal first, second and third quarters, respectively.

- ▼ **Dependence on Foreign Manufacturing and Imports:** RH's business highly depends on the successful operation of a global supply chain. In fiscal 2019, the company sourced approximately 86% of its merchandise from outside the United States, including 70% from Asia, majorly from China (38%). Thus, any economic or regulatory changes in the foreign countries will affect RH's business. Implementation of tax or tariffs may lead to an increase in the cost of goods sold and in turn higher product prices. This might also lead to a decline in consumer demand, denting the company's financial performance. RH noted that a major section of its products sourced from China has been affected by higher level of tariffs that were imposed in 2018 and 2019.

The presence of the COVID-19 virus and response to the health crisis in various countries are likely to have a continuing impact on its supply chain in the near term. RH expects the amount of products that it sources from China to be lower in fiscal 2020 than fiscal 2019.

- ▼ **Competition in Home Furnishings Sector:** The home furnishings sector is highly competitive. RH competes with interior design trade and specialty stores, antique dealers, national and regional home furnishing retailers and department stores. In addition, the company competes with mail order catalogs and online retailers focused on home furnishings. Increased catalog mailings by its competitors may affect response rates to RH's Source Book mailings. Increased competition has resulted in potential or actual litigation between RH and its competitors related to a variety of activities.
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Risks

- **Stellar Performance:** RH's shares have outperformed the industry in the past year. This trend is expected to continue in the near term, courtesy of its solid performance through fiscal 2019. The price performance was backed by the company's robust earnings surprise history, having surpassed the Zacks Consensus Estimate in all the trailing seven quarters.

In fiscal 2019, adjusted revenues increased 5.4% from the prior year, adjusted operating margins expanded 290 basis points (bps) to reach an industry best of 14.3%, and adjusted earnings per share advanced 49%. It also generated \$330 million of free cash flow in 2019.

RH has been exhibiting strong profitability, buoyed by its focus on improving profit margins, and creating a new and differentiating shopping experience with the addition of hospitality (restaurants and cafes) in new galleries. Focus on elevating the brand and architecting an integrated operating platform have aided RH in becoming one of the few retailers with expanding margins, rising operating earnings, while driving significantly higher returns on invested capital (industry-leading ROIC was 35.3% as of fiscal 2019).

- **Growth Initiatives to Drive Profitability:** Over the past three years, RH has been busy in architecting a new operating platform that includes transitioning from a promotional to membership model, distribution center network redesign, the redesign of reverse logistics and outlet business, and reconceptualization of its home delivery and customer experience. These initiatives have helped the company lower costs and inventory levels, while boosting earnings and inventory turns. Going forward, RH expects this multi-year effort to result in a dramatically improved customer experience, continued margin enhancement and significant cost savings over the next several years.

Notably, in 2016, the company transformed the business from a promotional to a membership model (RH Members Program), which is expected to enhance its brand, streamline operations and enhance customer experience. The membership model has eliminated the frantic buying patterns and associated returns, exchanges and canceled orders. This is expected to contribute to improved financial performance through higher conversion of demand into revenues, improved margins and lower costs. In fiscal 2019, RH's members, approximately 415,000 at the end of the year, drove roughly 95% of sales in the core RH business. Core RH business reflects the product categories to which membership discount can be applied. Hence, sales derived through Outlet, Contract, Hospitality or Waterworks are excluded.

- **Margin Expansion Initiatives:** From fiscal 2016 through fiscal 2019, RH significantly increased operating margins in its business. For the upcoming period, the company expects continued improvements in operating margins as a result of its focus on a number of strategic initiatives that include: (i) occupancy leverage that it expects to gain from real estate transformation (ii) product margin expansion as it continues to drive higher full price selling in core business and (iii) cost savings from improvements of its operating platform and organizational structure.

Management now expects long-term net revenue improvement of 8-12%, adjusted operating margins in high teens to low 20s, adjusted net income growth of 15-20% annually and ROIC in excess of 50%.

- **Active Management of Cash Flows:** RH's initiatives have been providing a major opportunity to optimize the allocation of capital in business, including generation of free cash flow, optimization of balance sheet, and deployment of capital to repay debt and repurchase shares.

RH pursues an aggressive share repurchase strategy. During fiscal 2019, RH repurchased approximately 2.2 million shares for roughly \$250 million. Notably, \$450 million is still available under the \$700-million repurchase program.

Share repurchases benefit the company's earnings per share, book value as well as shareholder equity as shares outstanding reduce. Thus, share repurchase programs raise optimism among investors and boost their confidence in the stock. The company generated \$330 million, \$163 million and \$415 million of free cash flow in fiscal 2019, 2018 and 2017, respectively.

Last Earnings Report

RH Beats on Q4 Earnings, Misses on Revenues, Withdraws '20 View

RH reported fourth-quarter fiscal 2019 results, wherein adjusted earnings beat the Zacks Consensus Estimate but revenues missed the same.

Earnings, Revenue & Margin Discussion

Adjusted earnings of \$3.72 per share surpassed the consensus mark of \$3.59 by 3.6%. Moreover, the reported figure increased 27% from the year-ago level.

Adjusted revenues (including recall accrual) of \$665 million missed the consensus mark of \$709.6 million by 6.3%. The figure also declined 1% from the year-ago figure of \$671.8 million.

While fourth-quarter adjusted revenues were lower than the company's expectation, adjusted earnings surpassed the same for the 13th consecutive quarter, as it continues to manage the business with a bias for earnings versus revenue growth. The lower revenues were due to two main reasons. First, the elimination of its Holiday assortment caused unforeseen collateral damage to its core business due to lower customer traffic in both stores and online during the peak weeks. Second, the company experienced higher-than-expected backorders due to a 18% year-over-year drop in inventories.

Adjusted gross margin increased 390 bps to 42.6% in the quarter. The company's adjusted operating margin expanded 230 bps year over year to a record 17.4%, driven by higher product margins, accompanied with lower occupancy and shipping costs owing to the elimination of Holiday assortment and continued efficiencies of a new operating platform. Adjusted EBITDA also grew 10.3% year over year to \$145 million in the quarter.

Store Update

As of Feb 1, 2020, RH operated 68 retail galleries. These include 40 Legacy Galleries, 22 Design Galleries, four Baby & Child Galleries, and two Modern Galleries throughout the United States and Canada. It also operated 15 Waterworks showrooms throughout the United States and in the U.K.

Balance Sheet

RH's cash and cash equivalents were \$47.7 million as of Feb 1, 2020 compared with \$5.8 million as on Feb 2, 2019. The company ended fiscal 2019 with merchandise inventories worth \$438.7 million compared with \$531.9 million as of Feb 2, 2019. Net cash provided by operating activities was \$339.2 million in fiscal 2019, reflecting an increase from \$249.6 million in the year-ago period.

Fiscal 2019 Highlights

Adjusted earnings of \$11.66 per share increased a notable 49.5% from \$7.80 a year ago. Adjusted revenues grew 5.4% to \$2,647 million from \$2,510.4 million a year ago. Adjusted gross margin expanded 190 bps to 41.4%. Adjusted operating margin grew 290 bps to 14.3% in fiscal 2019.

Withdraws Guidance Amid Coronavirus Crisis

In view of the major disruption in financial markets and retail business operations due to the COVID-19 outbreak, RH has withdrawn all prior guidance pertaining to fiscal 2020. Additionally, the company will take more steps such as deferring new business introductions and capital spending, while reducing costs to navigate through the short-term challenges of this crisis.

Quarter Ending 01/2020

Report Date	Mar 30, 2020
Sales Surprise	-6.28%
EPS Surprise	3.62%
Quarterly EPS	3.72
Annual EPS (TTM)	11.56

Valuation

RH's shares are down 58.2% in the year-to-date period and 15.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are down 54.1% and 14% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 44.5% and 7.5%, respectively.

The S&P 500 index is down 23.1% in the year-to-date period and 14.3% in the past year.

The stock is currently trading at 6.37X forward 12-month earnings, which compares to 9.78X for the Zacks sub-industry, 21.47X for the Zacks sector and 15.37X for the S&P 500 index.

Over the past five years, the stock has traded as high as 37.59X and as low as 5.85X, with a 5-year median of 16.27X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$76 price target reflects 5.43X forward 12-month earnings.

The table below shows summary valuation data for RH

Valuation Multiples - RH					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	6.37	9.78	21.47	15.37
	5-Year High	37.59	22.77	26.19	19.34
	5-Year Low	5.85	9.78	19.06	15.18
	5-Year Median	16.27	15.23	23.08	17.44
P/S F12M	Current	0.57	0.42	0.86	2.7
	5-Year High	1.78	1.31	1.11	3.43
	5-Year Low	0.38	0.42	0.8	2.54
	5-Year Median	0.83	0.85	0.92	3
EV/EBITDA TTM	Current	3.86	6.73	13.3	9.15
	5-Year High	17.49	11.95	16.25	12.88
	5-Year Low	2.63	5.22	10.89	8.27
	5-Year Median	7.18	8.31	12.52	10.78

As of 04/02/2020

Industry Analysis Zacks Industry Rank: Bottom 5% (242 out of 254)



Top Peers

At Home Group Inc. (HOME)	Outperform
The Home Depot, Inc. (HD)	Neutral
Haverty Furniture Companies, Inc. (HVT)	Neutral
The Lovesac Company (LOVE)	Neutral
Lowes Companies, Inc. (LOW)	Neutral
Ethan Allen Interiors Inc. (ETH)	Underperform
Tempur Sealy International, Inc. (TPX)	Underperform
Williams-Sonoma, Inc. (WSM)	Underperform

Industry Comparison Industry: Retail - Home Furnishings				Industry Peers		
	RH Underperform	X Industry	S&P 500	HD Neutral	HOME Outperform	WSM Underperform
VGM Score	C	-	-	C	D	A
Market Cap	1.69 B	180.72 M	17.16 B	194.86 B	93.60 M	2.94 B
# of Analysts	11	5	13	14	5	10
Dividend Yield	0.00%	0.00%	2.5%	3.31%	0.00%	5.05%
Value Score	C	-	-	C	A	A
Cash/Price	0.02	0.13	0.06	0.01	0.10	0.13
EV/EBITDA	7.59	5.99	10.80	12.43	12.89	5.57
PEG Ratio	0.81	0.81	1.74	1.63	0.86	1.17
Price/Book (P/B)	90.76	0.77	2.33	NA	0.11	2.39
Price/Cash Flow (P/CF)	4.05	4.35	9.11	14.61	0.96	5.24
P/E (F1)	10.15	10.15	14.73	17.87	8.69	11.68
Price/Sales (P/S)	0.64	0.30	1.81	1.77	0.07	0.50
Earnings Yield	9.85%	9.11%	6.71%	5.60%	11.64%	8.57%
Debt/Equity	75.90	0.89	0.70	-10.83	1.82	0.89
Cash Flow (\$/share)	22.00	1.91	7.01	12.41	1.52	7.26
Growth Score	C	-	-	B	F	A
Hist. EPS Growth (3-5 yrs)	41.69%	0.42%	10.92%	19.23%	8.49%	9.36%
Proj. EPS Growth (F1/F0)	-24.72%	-35.53%	1.02%	-1.01%	-70.53%	-32.67%
Curr. Cash Flow Growth	12.37%	6.33%	5.93%	0.60%	6.33%	6.05%
Hist. Cash Flow Growth (3-5 yrs)	61.75%	4.95%	8.55%	11.22%	64.94%	4.89%
Current Ratio	0.61	1.09	1.24	1.08	0.82	1.09
Debt/Capital	98.70%	55.78%	42.33%	NA	64.60%	46.97%
Net Margin	8.32%	2.73%	11.67%	10.20%	-15.71%	6.04%
Return on Equity	-232.62%	5.86%	16.70%	-599.49%	5.86%	33.13%
Sales/Assets	1.09	1.31	0.54	2.13	0.48	1.50
Proj. Sales Growth (F1/F0)	-7.07%	-0.93%	1.54%	1.84%	0.81%	-4.27%
Momentum Score	F	-	-	F	F	F
Daily Price Chg	0.54%	-0.87%	1.45%	1.50%	-12.05%	1.20%
1 Week Price Chg	35.07%	9.24%	12.29%	25.24%	8.82%	15.62%
4 Week Price Chg	-49.03%	-45.31%	-21.33%	-22.78%	-68.05%	-37.75%
12 Week Price Chg	-59.21%	-49.55%	-28.56%	-19.49%	-71.82%	-49.33%
52 Week Price Chg	-15.42%	-70.40%	-22.55%	-9.55%	-92.88%	-35.90%
20 Day Average Volume	2,287,593	511,860	4,257,668	10,348,297	3,752,782	1,945,621
(F1) EPS Est 1 week change	-33.37%	-22.10%	-0.04%	-1.68%	0.00%	0.00%
(F1) EPS Est 4 week change	-35.78%	-36.18%	-4.30%	-3.61%	-72.82%	-34.22%
(F1) EPS Est 12 week change	-35.92%	-36.92%	-5.47%	-3.28%	-72.08%	-34.00%
(Q1) EPS Est Mthly Chg	-79.43%	-97.55%	-5.91%	-2.06%	-498.18%	-96.95%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	C
Momentum Score	F
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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