

RH (RH)

\$214.06 (As of 02/04/20)

Price Target (6-12 Months): **\$225.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/03/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: F

Summary

Shares of RH have outperformed its industry in the past year. This trend is expected to continue 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. Its upbeat outlook for net revenues, adjusted operating income, operating margin and earnings for the current year in view of the current industry trends is also encouraging. Although market volatility and continued softness in the high-end housing market are concerns, RH remains confident to achieve financial goals in the long run on the back of its focus on improving profit margins and strategic initiatives. Estimates for fiscal 2020 have moved north over the past 60 days, reflecting optimism surrounding the stock. However, impact of exit from unprofitable business is a concern.

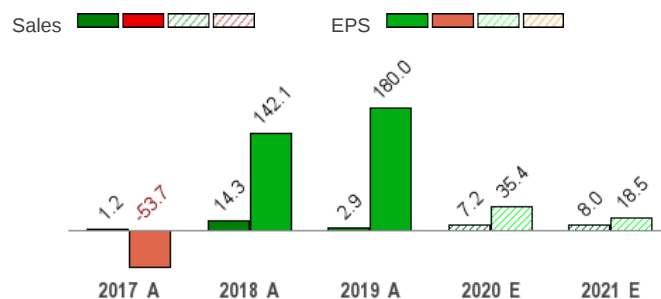
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$243.67 - \$84.11
20 Day Average Volume (sh)	829,262
Market Cap	\$4.1 B
YTD Price Change	0.3%
Beta	1.80
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Retail - Home Furnishings
Zacks Industry Rank	Top 32% (81 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	25.7%
Last Sales Surprise	0.2%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	03/26/2020
Earnings ESP	0.0%
P/E TTM	19.8
P/E F1	15.6
PEG F1	1.3
P/S TTM	1.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	647 E	765 E	735 E	780 E	2,905 E
2020	599 A	707 A	677 A	709 E	2,691 E
2019	557 A	643 A	639 A	672 A	2,510 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.53 E	\$3.85 E	\$3.21 E	\$4.23 E	\$13.70 E
2020	\$1.85 A	\$3.20 A	\$2.79 A	\$3.58 E	\$11.56 E
2019	\$1.33 A	\$2.05 A	\$1.73 A	\$3.00 A	\$8.54 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/04/2020. The reports text is as of 02/05/2020.

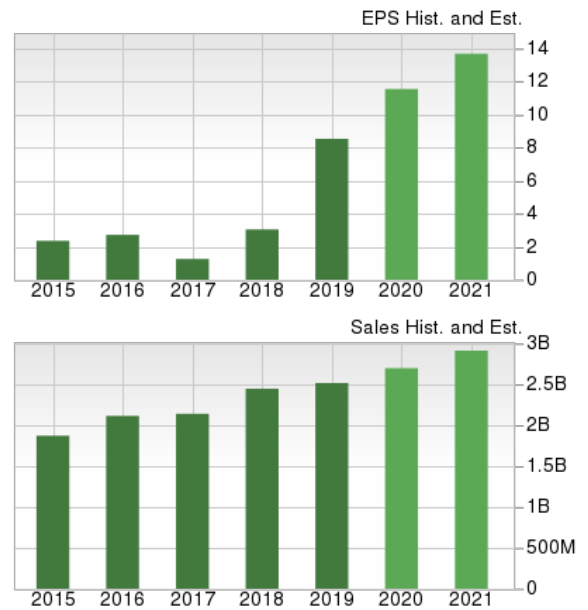
Overview

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 95.3% of third-quarter fiscal 2019 net revenues) and Waterworks (4.7%). 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 Nov 2, 2019, RH operated a total of 70 RH Galleries and 39 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 Buy:

▲ **Stellar Performance:** RH's shares have outperformed its industry in the past year. This trend is expected to continue in the near term, courtesy of solid performance through the first nine months of 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 six quarters.

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 27.8% as of fiscal 2018).

In the first nine months of fiscal 2019, the company's net sales recorded a 8.1% increase and adjusted earnings grew an impressive 60% on the back of significant growth in operating margin and lower adjusted effective tax rate. Adjusted gross margin was 41%, expanding 120 basis points (bps) from the year-ago level. Adjusted operating margins also grew 320 bps to 13.3% in the period.

▲ **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 2018, RH's members, approximately 418,000 at the end of the year, drove approximately 95% of sales in 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.

From fiscal 2016 through fiscal 2018, RH has markedly 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.

▲ **Margin Expectations in 2020 and Beyond:** Management expects operating margins to expand at least 200 basis points (bps) in 2020. This is expected to be driven by the following factors: 1) cycling 1,000 bps of margin erosion from outlet business liquidation, 2) transitioning the rug business from a single source importer to a direct sourcing model that will drive the category's margins by approximately 2,000 bps and 3) realization of platform efficiencies of \$15-\$20 million, with 1/3 of efficiencies realized in 2019 and 2/3 in 2020. The company is well poised to further boost operating margins, given pricing power and increased platform efficiency realizations.

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 the first six months of fiscal 2019, RH repurchased approximately 2.2 million shares for approximately \$115.36 million. Notably, \$450 million is still available under the \$700-million repurchase program. Notably, the company repurchased 2.05 million shares of common stock for \$250.3 million in fiscal 2018, which represents 10% of shares outstanding as of the end of fiscal 2017.

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 \$163 million and \$415 million in free cash flow in fiscal 2018 and fiscal 2017, respectively. For fiscal 2019, the company expects free cash flow between \$350 million and \$360 million.

The transformation to a membership model, rationalization of product offerings and the expansion of its chain of restaurants are expected to boost growth

Reasons To Sell:

▼ 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. 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.

Slowing high-end U.S. housing market, exit from unprofitable business, higher tariff, and higher dependence on foreign manufacturing and imports raise concerns.

▼ Dependence on Foreign Manufacturing and Imports:

RH's business highly depends on global trade. In fiscal 2018, the company sourced approximately 85% of its merchandise from outside the United States, including 73% from Asia, majorly from China (41%). 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.

▼ 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.

Last Earnings Report

RH Q3 Earnings & Revenues Beat, View Up for the Fourth Time

RH reported third-quarter fiscal 2019 results, wherein adjusted earnings and revenues handily beat the respective Zacks Consensus Estimate. Also, it raised its full-year guidance for the fourth time this year.

Earnings, Revenue & Margin Discussion

RH's third-quarter adjusted earnings of \$2.79 per share surpassed the consensus mark of \$2.22 by 25.7%. Moreover, the reported figure surged a notable 74% from the year-ago level.

Adjusted revenues (including recall accrual) of \$676.7 million topped the consensus mark of \$675.6 million by 0.2%. The said figure also increased 6% from the year-ago figure of \$638.5 million. Despite adverse macro trends and higher tariffs, revenues grew year over year on the back of the core RH business, solid performance of new galleries, along with continued expansion of RH Hospitality.

The company's adjusted operating margin expanded 340 basis points (bps) year over year to 13%. Adjusted EBITDA also grew 32.5% year over year to \$116.3 million in the quarter.

Store Update

As of Nov 2, 2019, RH operated 70 retail galleries. These include 42 Legacy Galleries, 21 Design Galleries, five Baby & Child Galleries, and two Modern Galleries. As of Nov 2, 2019, seven of RH Design Galleries included an integrated RH Hospitality experience. RH operated 71 retail galleries a year ago.

Balance Sheet

RH's cash and cash equivalents were \$38.3 million as of Nov 2, 2019 compared with \$5.8 million on Feb 2, 2019. The company ended the fiscal third quarter with merchandise inventories worth \$429.2 million compared with \$531.9 million as of Feb 2, 2019. Net cash provided by operating activities was \$211 million during the first nine months of 2019 compared with \$96.7 million in the comparable year-ago period.

Fiscal 2019 Guidance Up

Despite increase in tariffs and some negative macro trends, RH remains optimistic about business momentum.

In view of the recent trends, the company raised its full-year guidance for net revenues, adjusted operating income, operating margin and earnings for the fourth time this year. The company's focus on elevating the brand and architecting an integrated operating platform continues to reflect in its profit model leapfrogging past the home furnishings industry. Management believes that the company is gradually becoming one of the few retailers that is persistently boosting revenues, expanding margins, increasing operating earnings and driving significantly higher returns on invested capital.

Adjusted net revenues are now expected in the range of \$2,685-\$2,694 million versus \$2,680-\$2,694 million projected earlier.

Adjusted operating margin is now expected in the range of 14.1-14.2% (versus 13.6-13.8% estimated earlier). Adjusted earnings per share are projected between \$11.42 and \$11.54, higher than the prior guided range of \$10.78-\$11.01. Adjusted earnings are expected to grow 46-48% year over year.

Free cash flow is now expected within \$350-\$360 million versus \$325-\$350 expected earlier.

The company 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%.

Moreover, the company expects to accelerate Gallery openings to five-seven per year. Of these, it has plans to open five new Galleries and one Guesthouse in fiscal 2020, with RH Marin, RH Charlotte, and RH San Francisco opening in the first half; and RH Dallas, RH Jacksonville, and the first RH Guesthouse opening in New York by the second half of fiscal 2020.

RH has plans to open a minimum of seven new Galleries in fiscal 2021. It expects to launch RH Color next fall. RH International represents the company's largest growth opportunity that will position it to become a \$20-billion global brand.

Quarter Ending **10/2019**

Report Date	Dec 04, 2019
Sales Surprise	0.17%
EPS Surprise	25.68%
Quarterly EPS	2.79
Annual EPS (TTM)	10.84

Valuation

RH's shares are up 52.3% in the trailing 12-month period. Over the past year, the Zacks sub-industry and sector is up 16.4% and 15.3%, respectively.

The S&P 500 index is up 18.1% in the past year.

The stock is currently trading at 18.47X forward 12-month price to earnings, which compares to 14.73X for the Zacks sub-industry, 24.18X for the Zacks sector and 18.6X for the S&P 500 index.

Over the past five years, the stock has traded as high as 37.59X and as low as 9.73X, with a 5-year median of 16.48X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$225 price target reflects 19.41X 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 F 12M	Current	18.47	14.73	24.18	18.6
	5-Year High	37.59	21.87	26.2	19.34
	5-Year Low	9.73	12.53	19.07	15.18
	5-Year Median	16.48	15.68	22.96	17.46
P/S F12M	Current	1.51	0.82	1.05	3.45
	5-Year High	1.85	1.34	1.1	3.45
	5-Year Low	0.38	0.71	0.8	2.54
	5-Year Median	0.84	0.84	0.91	3
EV/EBITDA TTM	Current	7.74	10.65	15.29	11.95
	5-Year High	17.23	12.25	15.37	12.85
	5-Year Low	2.72	5.38	10.63	8.49
	5-Year Median	7.34	8.33	12.38	10.66

As of 02/04/2020

Industry Analysis Zacks Industry Rank: Top 32% (81 out of 255)



Top Peers

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

Industry Comparison Industry: Retail - Home Furnishings				Industry Peers		
	RH Neutral	X Industry	S&P 500	HD Neutral	HOME Neutral	WSM Neutral
VGM Score	B	-	-	C	C	B
Market Cap	4.07 B	394.27 M	24.31 B	256.35 B	375.66 M	5.52 B
# of Analysts	8	4	13	13	6	11
Dividend Yield	0.00%	0.00%	1.78%	2.31%	0.00%	2.69%
Value Score	B	-	-	C	A	B
Cash/Price	0.01	0.11	0.04	0.01	0.04	0.03
EV/EBITDA	13.65	9.30	13.98	16.10	15.16	11.48
PEG Ratio	1.25	0.76	2.01	1.99	0.63	1.80
Price/Book (P/B)	NA	1.47	3.29	NA	0.45	4.91
Price/Cash Flow (P/CF)	12.21	6.87	13.58	19.73	3.85	10.77
P/E (F1)	15.62	15.01	18.82	22.41	9.50	14.38
Price/Sales (P/S)	1.53	0.59	2.66	2.31	0.28	0.94
Earnings Yield	6.40%	6.31%	5.30%	4.46%	10.58%	6.95%
Debt/Equity	-23.61	0.32	0.71	-29.31	1.82	1.26
Cash Flow (\$/share)	17.53	2.04	6.92	11.91	1.52	6.61
Growth Score	B	-	-	C	F	B
Hist. EPS Growth (3-5 yrs)	41.69%	0.69%	10.80%	19.59%	10.66%	8.68%
Proj. EPS Growth (F1/F0)	18.51%	13.74%	7.40%	4.09%	13.85%	4.57%
Curr. Cash Flow Growth	66.37%	6.33%	10.22%	23.53%	6.33%	13.12%
Hist. Cash Flow Growth (3-5 yrs)	61.75%	2.48%	8.55%	13.51%	64.94%	5.62%
Current Ratio	0.62	1.13	1.21	1.08	0.82	1.29
Debt/Capital	NA%	60.18%	42.91%	NA	64.60%	55.77%
Net Margin	7.09%	3.16%	11.79%	10.01%	2.97%	5.86%
Return on Equity	-201.81%	6.79%	17.24%	-721.00%	6.79%	33.81%
Sales/Assets	1.17	1.31	0.55	2.22	0.51	1.63
Proj. Sales Growth (F1/F0)	7.94%	5.37%	4.10%	3.84%	11.12%	2.80%
Momentum Score	F	-	-	C	C	C
Daily Price Chg	2.61%	1.52%	1.49%	1.49%	2.45%	1.52%
1 Week Price Chg	-5.59%	-6.11%	-2.60%	-1.68%	-5.67%	-6.55%
4 Week Price Chg	-0.84%	-0.84%	0.51%	7.54%	5.02%	-3.39%
12 Week Price Chg	22.68%	0.00%	4.44%	0.81%	-32.18%	1.12%
52 Week Price Chg	52.20%	-36.71%	14.65%	26.08%	-74.73%	28.53%
20 Day Average Volume	829,262	277,257	1,935,862	4,357,425	1,935,064	757,579
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-0.02%	2.49%	0.33%
(F1) EPS Est 12 week change	10.52%	-6.36%	-0.10%	-4.01%	-20.12%	1.00%
(Q1) EPS Est Mthly Chg	0.00%	-2.03%	0.00%	0.00%	-8.33%	-0.81%

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	B
Growth Score	B
Momentum Score	F
VGM Score	B

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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