Restoration Hardware Holdings Inc
Form 10-Q
June 09, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended April 30, 2016

or

o 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)	45-3052669 (I.R.S. Employer Identification Number)
15 Koch Road, Suite K	
Corte Madera, CA (Address of principal executive offices)	94925 (Zip Code)

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

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 x No o

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 x No o

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

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

As of June 3, 2016, 40,606,527 shares of registrant's common stock were outstanding.

RESTORATION HARDWARE HOLDINGS, INC.

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PART I

Item 1. Financial Statements

RESTORATION HARDWARE HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

(Unaudited)

	April 30, 2016	January 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$237,156	$349,897
Short-term investments	100,095	130,801
Accounts receivable—net	32,080	28,567
Merchandise inventories	763,055	725,392
Prepaid expense and other current assets	112,049	79,020
Total current assets	1,244,435	1,313,677
Long-term investments	10,859	22,054
Property and equipment—net	558,431	515,605
Goodwill	124,435	124,301
Trademarks and other intangible assets	48,570	48,536
Non-current deferred tax assets	36,976	36,739
Other non-current assets	27,302	25,462
Total assets	$2,051,008	$2,086,374
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$248,971	$280,714
Deferred revenue and customer deposits	117,741	106,769
Other current liabilities	40,225	65,072
Total current liabilities	406,937	452,555
Convertible senior notes due 2019—net	301,311	297,703
Convertible senior notes due 2020—net	223,895	220,000
Financing obligations under build-to-suit lease transactions	154,953	146,621
Deferred rent and lease incentives	55,058	53,986
Other non-current obligations	29,326	29,349
Total liabilities	1,171,480	1,200,214
Commitments and contingencies (Note 15)	—	—
Stockholders' equity:		
Preferred stock, $0.0001 par value per share, 10,000,000 shares authorized, no shares	—	—

issued or outstanding as of April 30, 2016 and January 30, 2016		
Common stock, $0.0001 par value per share, 180,000,000 shares authorized, 40,900,613 shares issued and 40,605,725 shares outstanding as of April 30, 2016; 40,878,163 shares issued and 40,583,275 shares outstanding as of January 30, 2016	4	4
Additional paid-in capital	767,643	763,566
Accumulated other comprehensive income (loss)	61	(2,700)
Retained earnings	131,343	144,813
Treasury stock—at cost, 294,888 shares as of both April 30, 2016 and January 30, 2016	(19,523)	(19,523)
Total stockholders' equity	879,528	886,160
Total liabilities and stockholders' equity	$2,051,008	$2,086,374

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

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RESTORATION HARDWARE HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share amounts)

(Unaudited)

	Three Months Ended	
	April 30, 2016	May 2, 2015
Net revenues	$455,456	$422,445
Cost of goods sold	327,981	279,027
Gross profit	127,475	143,418
Selling, general and administrative expenses	138,950	126,389
Income (loss) from operations	(11,475)	17,029
Interest expense—net	10,528	5,649
Income (loss) before income taxes	(22,003)	11,380
Income tax expense (benefit)	(8,533)	4,224
Net income (loss)	$(13,470)	$7,156
Weighted-average shares used in computing basic net income (loss) per share	40,588,081	39,913,946
Basic net income (loss) per share	$(0.33)	$0.18
Weighted-average shares used in computing diluted net income (loss) per share	40,588,081	41,959,718
Diluted net income (loss) per share	$(0.33)	$0.17

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

RESTORATION HARDWARE HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

(Unaudited)

	Three Months Ended	
	April 30, 2016	May 2, 2015
Net income (loss)	$(13,470)	$7,156
Net gains (losses) from foreign currency translation	2,669	220
Net unrealized holding gains (losses) on available-for-sale investments	92	(2)
Total comprehensive income (loss)	$(10,709)	$7,374

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

RESTORATION HARDWARE HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended	
	April 30, 2016	May 2, 2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$(13,470)	$7,156
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	12,554	9,979
Amortization of debt discount	7,057	3,250
Excess tax (benefit) shortfall from exercise of stock options	76	(1,075)
Stock-based compensation expense	3,998	5,299
Other non-cash interest expense	1,126	536
Change in assets and liabilities:		
Accounts receivable	(3,504)	472
Merchandise inventories	(37,228)	(42,253)
Prepaid expense and other assets	(33,098)	(11,189)
Accounts payable and accrued expenses	(30,546)	7,673
Deferred revenue and customer deposits	10,972	3,046
Other current liabilities	(25,143)	1,444
Deferred rent and lease incentives	894	1,266
Other non-current obligations	20	17
Net cash used in operating activities	(106,292)	(14,379)
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(45,276)	(29,227)
Construction related deposits	(3,551)	—
Purchase of trademarks and domain names	(164)	—
Purchase of investments	(44,604)	(19,471)
Maturities of investments	54,368	15,000
Sales of investments	31,896	—
Net cash used in investing activities	(7,331)	(33,698)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on capital leases	(85)	(83)
Proceeds from exercise of stock options	296	2,221
Excess tax benefit (shortfall) from exercise of stock options	(76)	1,075
Tax withholdings related to issuance of stock-based awards	(141)	(376)
Net cash provided by (used in) financing activities	(6)	2,837
Effects of foreign currency exchange rate translation	888	73
Net decrease in cash and cash equivalents	(112,741)	(45,167)
Cash and cash equivalents		
Beginning of period	349,897	148,934
End of period	$237,156	$103,767
Non-cash transactions:		

Property and equipment additions in accounts payable and accrued expenses at period-end	$10,721	$8,380
Property and equipment additions due to build-to-suit lease transactions	7,775	47,404
Property and equipment additions from use of construction related deposits	1,740	2,942

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

RESTORATION HARDWARE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1—THE COMPANY

Nature of Business

Restoration Hardware Holdings, Inc., a Delaware corporation, together with its subsidiaries (collectively, the "Company"), is a luxury home furnishings retailer that offers a growing number of categories including furniture, lighting, textiles, bathware, décor, outdoor and garden, tableware, and child and teen furnishings. These products are sold through the Company's stores, catalogs and websites. As of April 30, 2016, the Company operated a total of 69 retail stores and 19 outlet stores in 29 states, the District of Columbia and Canada, and had sourcing operations in Shanghai and Hong Kong.

Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements have been prepared from the Company's records and, in management's opinion, include all adjustments necessary to fairly state the Company's financial position as of April 30, 2016, and the results of operations for the three months ended April 30, 2016 and May 2, 2015. The Company's current fiscal year ends on January 28, 2017 ("fiscal 2016").

Certain information and disclosures normally included in the notes to annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted for purposes of these interim condensed consolidated financial statements.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2016 (the "2015 Form 10-K"). Certain prior year amounts have been reclassified for consistency with the current period presentation. This reclassification had no effect on the previously reported consolidated results of operations or cash flows, and did not have a material effect on the previously reported consolidated financial position.

The results of operations for the three months ended April 30, 2016 presented herein are not necessarily indicative of the results to be expected for the full fiscal year.

NOTE 2—RECENTLY ISSUED ACCOUNTING STANDARDS

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ("FASB") and International Accounting Standards Board issued their converged accounting standard update on revenue recognition, Accounting Standards Update 2014-09—Revenue from Contracts with Customers (Topic 606). This guidance outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Under the new guidance, transfer of control is no longer the same as transfer of risks and rewards as indicated in the prior guidance. The Company will also need to apply the new guidance to determine whether revenue should be recognized over time or at a point in time. This guidance can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The FASB deferred the effective date for the new revenue reporting standard for entities reporting under U.S. GAAP for one year from the original effective date. In accordance with the deferral, ASU 2014-09 will become effective beginning after December 15, 2017 for public entities. Early application is permitted for annual reporting periods ending after December 15, 2016. The Company is evaluating the impact of adopting this new accounting standard on its consolidated financial statements and has not selected an adoption date or a transition method.

Consolidation Accounting

In February 2015, the FASB issued Accounting Standards Update No. 2015-02—Consolidation (Topic 810): Amendments to the Consolidation Analysis, which improves targeted areas of the consolidation guidance and reduces the number of consolidation models. The amendments to the guidance are effective for fiscal years beginning after December 15, 2015 (the Company's first quarter of fiscal 2016), and interim periods within those years, with early adoption permitted. The Company adopted this guidance in the first quarter of fiscal 2016. The adoption of this standard did not have a material impact on the Company's condensed consolidated financial statements and related disclosures.

Classification of Debt Issuance Costs

In April 2015, the FASB issued Accounting Standards Update 2015-03—Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in ASU 2015-03 require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Costs associated with line-of-credit arrangements may continue to be recorded as deferred assets. The update requires retrospective application and represents a change in accounting principle. The debt issuance costs guidance is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The Company adopted the guidance on a retrospective basis in the first quarter of fiscal 2016. This is a change from the Company's historical presentation whereby third party offering costs of the Company's convertible senior notes were classified within other non-current asset on the consolidated balance sheets. To conform to the current period presentation, the Company reclassified $2.1 million as of January 30, 2016 from non-current assets to non-current liabilities on the condensed consolidated balance sheets.

Software Licenses in Cloud Computing Arrangements

In April 2015, the FASB issued Accounting Standards Update No. 2015-05—Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. The amendments in ASU 2015-05 provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments in ASU 2015-05 are effective for fiscal years beginning after December 15, 2015, and interim periods within those years. The guidance may be applied either prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. The Company adopted this guidance on a prospective basis in the first quarter of fiscal 2016. The adoption of this standard did not have a material impact on the Company's condensed consolidated financial statements and related disclosures.

Measurement of Inventory

In July 2015, the FASB issued Accounting Standards Update 2015-11—Inventory (Topic 330): Simplifying the Measurement of Inventory, which changes the measurement principle for inventory from the lower of cost or market to the lower of cost and net realizable value. ASU 2015-11 defines net realizable value as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The guidance must be applied on a prospective basis and is effective for periods beginning after December 15, 2016, with early adoption permitted. The Company adopted this guidance on a prospective basis in the first quarter of fiscal 2016. The adoption of this standard did not have a material impact on the Company's condensed consolidated financial statements and related disclosures.

Business Combinations

In September 2015, the FASB issued Accounting Standards Update 2015-16—Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The guidance requires the acquirer to recognize adjustments to provisional amounts identified during the measurement period in the reporting period in which the adjustment amounts are determined. The business combination guidance is effective for interim and annual periods beginning after December 15, 2015, with early adoption permitted, and is to be applied on a prospective basis. The Company adopted this guidance on a prospective basis in the first quarter of fiscal 2016. The adoption of this standard did not have a material impact on the Company's condensed consolidated financial statements and related disclosures.

Accounting for Leases

In February 2016, the FASB issued Accounting Standards Update 2016-02—Leases, which, for operating leases, requires a lessee to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. The standard also requires a lessee to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term, on a generally straight-line basis. The ASU is effective for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the effects that the adoption of ASU 2016-02 will have on its consolidated financial statements and anticipates the new guidance will significantly impact its consolidated financial statements given the Company has a significant number of leases.

Financial Instruments

In January 2016, the FASB issued Accounting Standards Update 2016-01—Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which amends various aspects of the recognition, measurement, presentation and disclosure for financial instruments. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted only for certain provisions. The Company is evaluating the impact of adopting this new accounting standard on its consolidated financial statements.

Recognition of Breakage

In March 2016, the FASB issued Accounting Standard Update No. 2016-04—Recognition of Breakage for Certain Prepaid Stored-Value Products. The new guidance creates an exception under ASC 405-20—Liabilities-Extinguishments of Liabilities, to derecognize financial liabilities related to certain prepaid stored-value products using a revenue-like breakage model. The new guidance is effective in fiscal years beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted. This guidance can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the impact of adopting this new accounting standard on its consolidated financial statements.

Stock-Based Compensation

In March 2016, the FASB issued Accounting Standard Update No. 2016-09—Improvements to Employee Share Based Payment Accounting. The new guidance simplifies several aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new guidance is effective in fiscal years beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted. The Company is evaluating the impact of adopting this new accounting standard on its consolidated financial statements.

NOTE 3—PREPAID EXPENSE AND OTHER ASSETS

Prepaid expense and other current assets consist of the following (in thousands):

	April 30, 2016	January 30, 2016
Capitalized catalog costs	$40,516	$35,836
Vendor deposits	33,868	22,959
Federal and state tax receivable	10,717	—
Prepaid expense and other current assets	26,948	20,225
Total prepaid expense and other current assets	$112,049	$79,020

Other non-current assets consist of the following (in thousands):

	April 30, 2016	January 30, 2016

Construction related deposits	$17,195	$15,384
Other deposits	3,676	3,635
Deferred financing fees	2,059	2,236
Other non-current assets	4,372	4,207
Total other non-current assets	$27,302	$25,462

NOTE 4—GOODWILL AND INTANGIBLE ASSETS

The following sets forth the goodwill and intangible assets as of April 30, 2016 (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net Book Value
Intangible assets subject to amortization				
Fair value of leases (1)				
Fair market write-up	$1,924	$ (1,720)	$ —	$204
Fair market write-down (2)	(1,467)	1,308	—	(159)
Total intangible assets subject to amortization	$457	$ (412)	$ —	$45
Intangible assets not subject to amortization				
Goodwill	$124,461	$ —	$ (26)	$124,435
Trademarks and domain names	$48,366	$ —	$ —	$48,366

(1) The fair value of each lease is amortized over the life of the respective lease.
(2) The fair market write-down of leases is included in other non-current obligations on the condensed consolidated balance sheets.

The following sets forth the goodwill and intangible assets as of January 30, 2016 (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net Book Value
Intangible assets subject to amortization				
Fair value of leases (1)				
Fair market write-up	$1,924	$ (1,697)	$ —	$227
Fair market write-down (2)	(1,467)	1,289	—	(178)
Total intangible assets subject to amortization	$457	$ (408)	$ —	$49
Intangible assets not subject to amortization				
Goodwill	$124,461	$ —	$ (160)	$124,301
Trademarks and domain names	$48,309	$ —	$ —	$48,309

(1) The fair value of each lease is amortized over the life of the respective lease.
(2) The fair market write-down of leases is included in other non-current obligations on the condensed consolidated balance sheets.

NOTE 5—ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accounts payable and accrued expenses consist of the following (in thousands):

	April 30, 2016	January 30, 2016
Accounts payable	$148,535	$175,024
Accrued compensation	32,744	27,698
Accrued freight and duty	21,304	27,230
Accrued sales taxes	14,649	19,269
Accrued occupancy	12,066	15,095
Accrued catalog costs	6,921	