

Restoration Hardware Holdings Inc
Form 10-Q
June 12, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended May 3, 2014

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)

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

15 Koch Road, Suite J

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 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 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 June 6, 2014, 39,374,139 shares of registrant's common stock were outstanding.

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RESTORATION HARDWARE HOLDINGS, INC.

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Table of Contents**PART I****Item 1. Financial Statements****RESTORATION HARDWARE HOLDINGS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share amounts)****(Unaudited)**

	May 3, 2014	February 1, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 10,942	\$ 13,389
Accounts receivable net	18,922	22,028
Merchandise inventories	483,530	453,845
Current deferred tax assets	21,400	21,400
Prepaid expense and other current assets	126,872	103,153
Total current assets	661,666	613,815
Property and equipment net	241,053	214,909
Goodwill	124,627	122,424
Trademarks and domain names	47,410	47,410
Other intangible assets net	1,335	1,298
Non-current deferred tax assets	16,985	16,980
Other assets	6,880	8,267
Total assets	\$ 1,099,956	\$ 1,025,103
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 215,381	\$ 206,778
Deferred revenue and customer deposits	53,933	53,595
Current deferred tax liabilities	143	145
Other current liabilities	33,227	56,930
Total current liabilities	302,684	317,448
Revolving line of credit	149,146	85,425
Deferred rent and lease incentives	38,356	37,727
Other long-term obligations	67,543	39,231
Total liabilities	557,729	479,831

Commitments and contingencies (See Note 12 to the unaudited condensed consolidated financial statements)

Stockholders' equity:

Common stock, \$0.0001 par value per share, 180,000,000 shares authorized, 39,373,425 shares issued and outstanding as of May 3, 2014 and 39,124,764 shares issued and outstanding as of February 1, 2014	4	4
Additional paid-in capital	595,419	584,641
Accumulated other comprehensive income	693	629
Accumulated deficit	(35,497)	(37,292)
Treasury stock at cost, 281,675 and 40,353 shares, respectively	(18,392)	(2,710)
Total stockholders' equity	542,227	545,272
Total liabilities and stockholders' equity	\$ 1,099,956	\$ 1,025,103

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	
	May 3, 2014	May 4, 2013
Net revenues	\$ 366,254	\$ 301,337
Cost of goods sold	241,905	199,460
Gross profit	124,349	101,877
Selling, general and administrative expenses	119,571	101,366
Income from operations	4,778	511
Interest expense	(2,056)	(840)
Income (loss) before income taxes	2,722	(329)
Income tax expense (benefit)	927	(168)
Net income (loss)	\$ 1,795	\$ (161)
Weighted-average shares used in computing basic net income (loss) per share	39,152,923	38,076,026
Basic net income (loss) per share	\$ 0.05	\$
Weighted-average shares used in computing diluted income (loss) per share	40,787,726	38,076,026
Diluted net income (loss) per share	\$ 0.04	\$

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 COMPREHENSIVE INCOME (LOSS)

(In thousands)

(Unaudited)

	Three Months Ended	
	May 3, 2014	May 4, 2013
Net income (loss)	\$ 1,795	\$ (161)
Foreign currency translation adjustment net of tax	64	(31)
Total comprehensive income (loss)	\$ 1,859	\$ (192)

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 CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended	
	May 3, 2014	May 4, 2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 1,795	\$ (161)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	7,640	6,630
Excess tax benefit from exercise of stock options	(5,364)	
Stock-based compensation expense	2,231	3,631
Non-cash interest expense	168	168
Change in assets and liabilities:		
Accounts receivable	3,106	(672)
Merchandise inventories	(29,631)	(12,437)
Prepaid expense and other assets	(19,665)	(44,707)
Accounts payable and accrued expenses	4,346	25,978
Deferred revenue and customer deposits	338	1,257
Other current liabilities	(22,822)	534
Deferred rent and lease incentives	593	115
Other long-term obligations	46	41
Net cash used in operating activities	(57,219)	(19,623)
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(16,515)	(9,737)
Net cash used in investing activities	(16,515)	(9,737)
CASH FLOWS FROM FINANCING ACTIVITIES		
Gross borrowings under revolving line of credit	469,594	353,258
Gross repayments under revolving line of credit	(405,873)	(321,765)
Payments on capital leases	(985)	(840)
Stock options exercised	3,500	
Excess tax benefit from exercise of stock options	5,364	
Tax withholdings related to issuance of stock-based awards	(317)	
Net cash provided by financing activities	71,283	30,653
Effects of foreign currency exchange rate translation	4	22

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Net increase (decrease) in cash and cash equivalents	(2,447)	1,315
Cash and cash equivalents		
Beginning of period	13,389	8,354
End of period	\$ 10,942	\$ 9,669

Non-cash transactions:

Property and equipment acquired under capital lease	\$ 93	\$
Property and equipment acquired under build-to-suit transactions	12,587	
Property and equipment additions in accounts payable	11,944	8,107

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

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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 children's furnishings. These products are sold through the Company's stores, catalogs and websites. As of May 3, 2014, the Company operated a total of 69 retail stores and 17 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 May 3, 2014, and the results of operations for the three months ended May 3, 2014 and May 4, 2013. The Company's current fiscal year ends on January 31, 2015 (fiscal 2014).

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 February 1, 2014 (2013 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, financial position or cash flows.

The results of operations for the three months ended May 3, 2014 presented herein are not necessarily indicative of the results to be expected for the full fiscal year.

Acquisition

On February 3, 2014, the Company completed a business acquisition from an entity that is owned by an employee of the Company for an aggregate purchase price of \$2.5 million. The Company accounted for this acquisition utilizing the purchase method. In accordance with the purchase method, all assets and liabilities were recorded at fair value, including goodwill and other intangible assets acquired. Goodwill and other intangible assets related to this acquisition are included in these condensed consolidated financial statements.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

Accounting for Leases

The Financial Accounting Standards Board (FASB) is currently working on amendments to existing accounting standards governing a number of areas including, but not limited to, accounting for leases. In May 2013, the FASB issued a new exposure draft, *Leases (Topic 841)* (the Exposure Draft), which would replace the existing guidance in ASC 840. Under the Exposure Draft, among other changes in practice, a lessee's rights and obligations under most leases, including existing and new arrangements, would be recognized as assets and liabilities, respectively, on the balance sheet. Other significant provisions of the Exposure Draft include (i) defining the lease term to include the noncancellable period together with periods for which there is a significant economic incentive for the lessee to extend or not terminate the lease; (ii) defining the initial lease liability to be recorded on the balance sheet to contemplate only those variable lease payments that depend on an index or that are in substance fixed ; and (iii) a dual approach for determining whether lease expense is recognized on a straight-line or accelerated basis, depending on whether the lessee is expected to consume more than an insignificant portion of the leased asset's economic benefits. The comment period for the Exposure Draft ended on September 13, 2013. If and when effective, this Exposure Draft will likely have a significant impact on the Company's consolidated financial statements. However, as the standard-setting process is still ongoing, the Company is unable to determine the impact this proposed change in accounting standards will have on its consolidated financial statements.

Presentation of Unrecognized Tax Benefits

In July 2013, the FASB issued an Accounting Standards Update, which requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, with certain exceptions. This guidance is effective for annual and interim reporting periods beginning after December 15, 2013, with early adoption permitted. The Company adopted this guidance in the first quarter of fiscal 2014 and adoption did not have a material impact on its consolidated financial statements.

Table of Contents**Revenue from Contracts with Customers**

In May 2014, the FASB and International Accounting Standards Board issued their converged standard on revenue recognition, *Accounting Standards Update 2014-09 Revenue from Contracts with Customers (Topic 606)*. This standard 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. Transfer of control is not the same as transfer of risks and rewards, as it is considered in current guidance. The Company will also need to apply new guidance to determine whether revenue should be recognized over time or at a point in time. This standard will be effective for the first interim period within annual reporting periods beginning after December 15, 2016, with no early adoption permitted, and is required to be applied retrospectively. The Company has reviewed the standard and does not believe it will have a material impact on its consolidated financial statements.

NOTE 3 PREPAID EXPENSE AND OTHER CURRENT ASSETS

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

	May 3, 2014	February 1, 2014
Capitalized catalog costs	\$ 73,718	\$ 49,274
Vendor deposits	31,611	36,694
Prepaid expense and other current assets	21,543	17,185
 Total prepaid expense and other current assets	 \$ 126,872	 \$ 103,153

NOTE 4 GOODWILL AND INTANGIBLE ASSETS

The following sets forth the goodwill and intangible assets as of May 3, 2014 (*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	\$ 10,643	\$ (9,411)	\$ 43	\$ 1,275
Fair market write-down ⁽²⁾	(2,591)	2,119		(472)
Customer relationships ⁽³⁾	80	(20)		60
 Total intangible assets subject to amortization	 8,132	 (7,312)	 43	 863
Intangible assets not subject to amortization:				
Goodwill	124,461		166	124,627
Trademarks and domain names	47,410			47,410

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Total intangible assets	\$ 180,003	\$ (7,312)	\$ 209	\$ 172,900
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- (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 long-term obligations on the condensed consolidated balance sheets.
- (3) Customer relationships are amortized over a one-year period.

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The following sets forth the goodwill and intangible assets as of February 1, 2014 (*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	\$ 10,443	\$ (9,187)	\$ 42	\$ 1,298
Fair market write-down ⁽²⁾	(2,591)	2,072		(519)
Total intangible assets subject to amortization	7,852			