

RH

Rates & industry promos weigh on 2H, but growth story intact for 2024; Buy

Reiterate Rating: BUY | PO: 309.00 USD | Price: 281.40 USD

Rev/EBIT miss driven by housing weakness, int'l costs

Reported 3Q rev of \$751mn (\$10mn & \$5mn below our est. & Street, respectively), declined 14% y/y, a 5pt acceleration vs. 2Q but still pressured by elevated mortgage rates, which peaked above 8% in early-Oct. Total store count reached 125 and, in November, RH opened stores in Munich and Düsseldorf, the company's first expansion into continental Europe. Adj. EBIT of \$55.2mn (7.3% margin) was well below Street's \$74mn due to lower volume leverage and higher than anticipated expenses, including int'l openings and costs related to the 4Q acquisition of the NY Guesthouse for \$58mn.

FY23 rev guide narrowed with EBIT range lowered

Guided FY23 rev to \$3.06-3.08bn, narrowed from \$3.04-3.10bn, with mdpt maintained at \$3.07bn suggesting a 14% y/y contraction for the year. Implied 4Q revenue guide suggests 1% y/y growth, a strong 15pt accel on a relatively stable comp driven by incremental demand from the Interior and Contemporary Sourcebooks despite Modern Sourcebook now delayed until 1Q'24. Adj operating margin guide was lowered to 13.6-14.0% from 14.5-15.5%, likely from industry promotions shifting consumers to clearance pricing, and suggests 11.6-13.2% margin for the quarter, or \$91-103mn.

Lowering 2023 revenue/adj. EBIT projections by 2/11%

We lower FY23E revenue by 1% to \$3.08bn, adj. EBIT by 11% to \$428mn, and adj. EPS by 20% to \$8.27 (vs. prior \$10.40). For 2024E, we lower revenue slightly to \$3.38bn, adj. EBIT by 8% to \$566mn (primarily on 1H'24 GM), and adj. EPS by 12% to \$14.91.

2024 growth story still intact despite muddy print; Buy

We see the print as disappointing; a tougher operating environment (Oct. mortgage spike and increased industry promos) is driving a narrowing of sales guidance (though the FY23 mdpt was maintained at \$3.07bn), a delay of Sourcebook mailings until 1Q'24, and lower margin guidance. In our view, shares may be range bound in the near-term (shares down 9% AMC), and we would look for RH to show sustained evidence of improvement and more clarity on the impact to '24 margins on product/gallery ramp. We remain positive on outlook for 2024 on a possible housing trough and new gallery conversions, compounded by mgmt. expecting an acceleration in demand trends in 1H'24 on the largest product launch in RH's history. We lower our PO to \$309 (from \$345) based on lower operating income outlook but higher 21x 2024E EPS multiple (from 20x) on cont. confidence in earnings accelerating next year. Reiterate our Buy rating on RH.

Estimates (Jan) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	26.12	20.06	8.27	14.91	24.45
GAAP EPS	23.51	18.59	8.27	14.91	24.45
EPS Change (YoY)	54.0%	-23.2%	-58.8%	80.3%	64.0%
Consensus EPS (Bloomberg)			9.92	13.89	NA
DPS	0	0	0	0	0
Valuation (Jan)					
P/E	10.8x	14.0x	34.0x	18.9x	11.5x
GAAP P/E	12.0x	15.1x	34.0x	18.9x	11.5x
EV / EBITDA*	7.8x	9.2x	15.2x	12.0x	9.4x
Free Cash Flow Yield*	9.3%	4.5%	3.8%	4.5%	8.2%

* For full definitions of *IQmethod*SM measures, see page 5.

07 December 2023

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	345.00	309.00
2024E Rev (m)	3,100.0	3,077.2
2025E Rev (m)	3,392.1	3,376.7
2026E Rev (m)	3,808.6	3,794.4
2024E EPS	10.40	8.27
2025E EPS	16.93	14.91
2026E EPS	24.66	24.45

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Stock Data

Price	281.40 USD
Price Objective	309.00 USD
Date Established	7-Dec-2023
Investment Opinion	C-1-9
52-Week Range	207.26 USD - 406.38 USD
Mrkt Val (mn) / Shares Out (mn)	5,127 USD / 18.2
Free Float	81.1%
Average Daily Value (mn)	182.33 USD
BofA Ticker / Exchange	RH / NYS
Bloomberg / Reuters	RH US / RH.N
ROE (2024E)	58.4%
Net Dbt to Eqty (Jan-2023A)	-192.7%
ESGMeter TM	Medium

ESGMeterTM is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

AMC: After market close

GM: gross margin

Mdpt: Midpoint

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iQprofileSM RH

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	24.9%	13.7%	8.5%	13.2%	17.7%
Return on Equity	95.6%	54.1%	58.4%	NM	NM
Operating Margin	25.6%	22.0%	13.9%	16.8%	19.8%
Free Cash Flow	477	230	197	232	420

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.9x	0.8x	2.1x	1.4x	1.3x
Asset Replacement Ratio	1.9x	1.6x	1.5x	1.5x	1.4x
Tax Rate	16.4%	22.7%	22.3%	22.0%	24.0%
Net Debt-to-Equity Ratio	-186.1%	-192.7%	NM	NM	NM
Interest Cover	18.1x	7.1x	2.3x	3.3x	5.4x

Income Statement Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	3,758	3,590	3,077	3,377	3,794
% Change	31.8%	-4.4%	-14.3%	9.7%	12.4%
Gross Profit	1,854	1,823	1,430	1,626	1,897
% Change	39.0%	-1.7%	-21.6%	13.7%	16.7%
EBITDA	1,058	897	541	685	873
% Change	46.8%	-15.2%	-39.7%	26.5%	27.5%
Net Interest & Other Income	(53)	(109)	(188)	(174)	(138)
Net Income (Adjusted)	773	529	175	292	447
% Change	67.0%	-31.6%	-66.8%	66.6%	53.0%

Free Cash Flow Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	696	492	186	306	465
Depreciation & Amortization	95	107	113	118	123
Change in Working Capital	(279)	(498)	(133)	(204)	(185)
Deferred Taxation Charge	0	(92)	41	0	0
Other Adjustments, Net	150	395	164	186	192
Capital Expenditure	(185)	(174)	(175)	(175)	(175)
Free Cash Flow	477	230	197	232	420
% Change	22.4%	-51.7%	-14.3%	17.7%	81.1%
Share / Issue Repurchase	0	(1,000)	(1,208)	(450)	(625)
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	1,610	58	0	0	0

Balance Sheet Data (Jan)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	2,178	1,512	501	283	78
Trade Receivables	0	0	0	0	0
Other Current Assets	914	1,001	846	878	949
Property, Plant & Equipment	1,228	1,636	1,698	1,754	1,806
Other Non-Current Assets	1,221	1,161	998	1,013	1,034
Total Assets	5,540	5,309	4,043	3,928	3,866
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	1,051	884	639	642	702
Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities	3,306	3,639	3,589	3,589	3,590
Total Liabilities	4,357	4,523	4,227	4,231	4,292
Total Equity	1,170	785	(184)	(303)	(426)
Total Equity & Liabilities	5,527	5,308	4,043	3,928	3,866

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Retailing-Hardlines

Company Description

RH is a retailer of high-end home furnishings including furniture, lighting, textiles, bathware, décor and outdoor with locations across the US and Canada. The company targets wealthy consumers with incomes of \$250k or greater. Over the last decade, the company has transformed itself from a retailer of eclectic collectibles and decorative items to luxury furniture and home goods. It generates sales through stores and a direct channel.

Investment Rationale

RH has built a differentiated retail experience and brand name that we believe protects it from intensifying online competition that is pressuring the rest of the home furnishings market. While the company has a history of execution missteps and highly volatile earnings, we believe RH has hit an inflection for steadier growth and margins in its core business which should support higher earnings and multiple expansion.

Stock Data

Average Daily Volume 647,945

Quarterly Earnings Estimates

	2023	2024
Q1	6.63A	2.23A
Q2	6.12A	3.93A
Q3	4.26A	-0.42A
Q4	2.88A	1.84E

Actuals vs. Estimates

Exhibit 1: Actuals vs. Estimates

Rev/adj operating income of \$751mn/\$55 was below Street at \$756mn/\$74mn

(Dollars and shares in millions)	3Q22	3Q23	Y/Y change	vs. BofA est	BofA 3Q23
Total Sales	\$869	\$751	-13.6%	-1.2%	\$760
Cost of sales	\$437	\$411	-6.1%	3.9%	\$395
Gross profit	\$432	\$340	-21.1%	-6.7%	\$365
SG&A expenses	\$251	\$285	13.5%	-1.3%	\$289
Operating income	\$180	\$55	-69.4%	-27.4%	\$76
Net int. income (exp)	\$31	\$54	73.3%	20.4%	\$45
Other expenses	\$2	\$5			\$0
Pretax income	\$147	(\$5)	-103.1%	-114.9%	\$31
Income tax expense	\$35	\$1	-98.5%	-93.1%	\$7
Share of equity method investments	\$2	\$3			\$3
Net income from cont ops	\$110	(\$8)	-107.1%	-138.2%	\$20
Extraordinary items (loss)	(\$12)	\$6			0.0
GAAP net income	\$99	(\$2)	-102.2%	-110.7%	\$20
Diluted EPS from cont ops	\$4.26	(\$0.42)	-110.0%	-142.1%	\$1.01
GAAP EPS reported	\$3.81	(\$0.12)	-103.1%	-111.8%	\$1.01
Average shares - diluted	25.9	18.4	-29.1%	-9.3%	20.3
Margin analysis					
Gross margin	49.7%	45.3%	-436 bp	-268 bp	48.0%
SG&A to sales	28.9%	38.0%	905 bp	-2 bp	38.0%
Operating margin	20.8%	7.3%	-1341 bp	-266 bp	10.0%
Pretax margin	16.9%	-0.6%	-1752 bp	-466 bp	4.1%
Net margin	12.7%	-1.0%	-1374 bp	-372 bp	2.7%
Tax rate	23.6%	-11.0%	-3461 bp	-3502 bp	24.0%

Source: Company reports, BofA Global Research estimates

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Estimate Changes

Exhibit 2: Estimate Changes

For 2024, we lower revenue slightly to \$3.38bn, adj. EBIT by 8% to \$566mn, and adj. EPS by 12% to \$14.91

Estimate Changes	New	4Q23 Prior	Var.	New	2023 Prior	Var.	New	2024 Prior	Var.
Total revenue	786	800	-2%	3,077	3,100	-1%	3,377	3,392	0%
Gross profit	362	392	-8%	1,430	1,485	-4%	1,626	1,680	-3%
EBIT	101	132	-23%	428	480	-11%	566	615	-8%
Non-GAAP EPS	\$1.84	\$3.16	-42%	\$8.27	\$10.40	-20%	\$14.91	\$16.93	-12%

Source: BofA Global Research estimates

BofA GLOBAL RESEARCH

Price objective basis & risk

RH (RH)

Our price objective on RH is \$309, which is based on 21x 2024E P/E. Our valuation is above the average multiple of 17x on a proven track record of consistently growing margins as well as several large and long-term revenue opportunities that could deliver upside.

The upside risks to our price objective are continued upside potential from RH's gallery conversion strategy, international growth, operating leverage on sales growth, and supply-chain cost reductions and greater-than-expected share repurchases.

Downside risks to our price objective are weakness in discretionary spending or a recession, which would likely have an outsized impact on RH's luxury brand.

Analyst Certification

I, Curtis Nagle, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Internet Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Alphabet	GOOGL	GOOGL US	Justin Post
	Alphabet	GOOG	GOOG US	Justin Post
	Amazon.com	AMZN	AMZN US	Justin Post
	AppLovin	APP	APP US	Omar Dessouky, CFA
	DoorDash	DASH	DASH US	Michael McGovern
	Electronic Arts	EA	EA US	Omar Dessouky, CFA
	Expedia	EXPE	EXPE US	Justin Post
	LegalZoom	LZ	LZ US	Michael McGovern
	Match Group	MTCH	MTCH US	Curtis Nagle, CFA
	Meta Platforms Inc	META	META US	Justin Post
	Pinterest	PINS	PINS US	Justin Post
	RH	RH	RH US	Curtis Nagle, CFA
	Roblox Corp. Class A	RBLX	RBLX US	Omar Dessouky, CFA
	Squarespace, Inc.	SQSP	SQSP US	Michael McGovern
	Uber	UBER	UBER US	Justin Post
	Udemy Inc	UDMY	UDMY US	Curtis Nagle, CFA
	Wayfair	W	W US	Curtis Nagle, CFA
	Zillow	ZG	ZG US	Curtis Nagle, CFA
	Zillow	Z	Z US	Curtis Nagle, CFA
NEUTRAL				
	ACV Auctions	ACVA	ACVA US	Curtis Nagle, CFA
	Airbnb	ABNB	ABNB US	Justin Post
	Beyond Inc	BYON	BYON US	Curtis Nagle, CFA
	Booking Holdings Inc	BKNG	BKNG US	Justin Post
	Bumble	BMBL	BMBL US	Curtis Nagle, CFA
	Digital Turbine, Inc	APPS	APPS US	Omar Dessouky, CFA
	Duolingo	DUOL	DUOL US	Curtis Nagle, CFA
	eBay	EBAY	EBAY US	Justin Post
	Etsy, Inc.	ETSY	ETSY US	Curtis Nagle, CFA
	Instacart	CART	CART US	Justin Post
	Playtika	PLTK	PLTK US	Omar Dessouky, CFA
	Snap	SNAP	SNAP US	Justin Post
	Take-Two Interactive	TTWO	TTWO US	Omar Dessouky, CFA
UNDERPERFORM				
	Chewy Inc	CHWY	CHWY US	Curtis Nagle, CFA
	Lyft, Inc.	LYFT	LYFT US	Michael McGovern

US - Internet Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Opendoor Technologies	OPEN	OPEN US	Curtis Nagle, CFA
	Peloton	PTON	PTON US	Curtis Nagle, CFA
	Redfin Corp	RDFN	RDFN US	Curtis Nagle, CFA
	Shutterstock	SSTK	SSTK US	Curtis Nagle, CFA
RSTR				
	Vivid Seats	SEAT	SEAT US	Curtis Nagle, CFA

IQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales
Basic EBIT + Depreciation + Amortization

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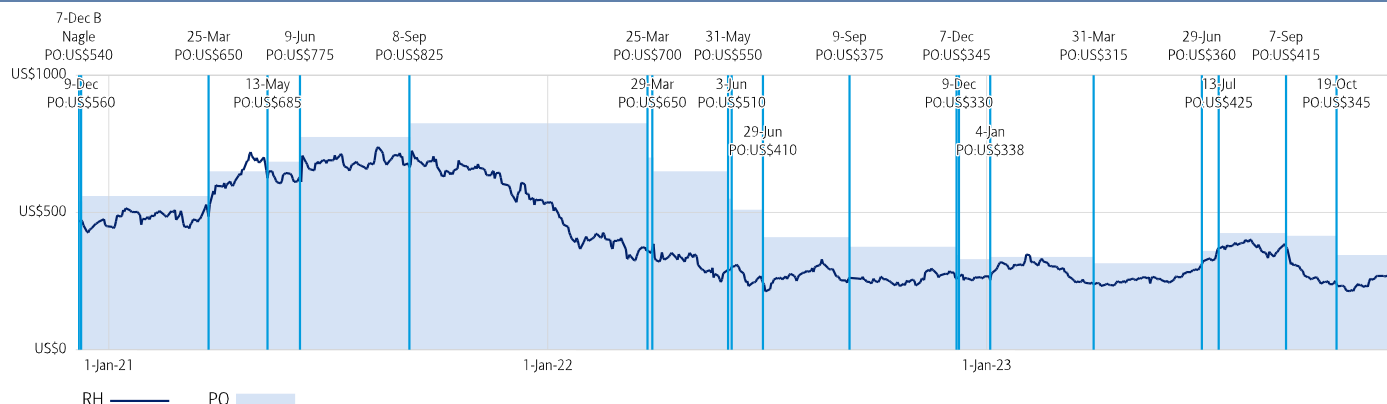
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Important Disclosures

RH (RH) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Retailing Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	89	53.94%	Buy	37	41.57%
Hold	34	20.61%	Hold	14	41.18%
Sell	42	25.45%	Sell	19	45.24%

Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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