

RIH

MOI GLOBAL BEST IDEAS PRESENTATION
JANUARY 2020

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RH

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Mental Model:

“I look for opportunity in things that don’t make sense and/or things that are obvious.”

-Adam Robinson

Adam’s interviews with Shane Parrish and Tim Ferris are worth listening to.

RH is not Hermes!

"All the best luxury brands, whether it's Hermès, Louis Vuitton, Chanel, you name it, on and on, Christian Dior and all the others, they were all born at the top of the luxury mountain," Friedman (CEO of RH) said.

"We're one of the few that is trying to make the climb," he continued. "The people at the top of the luxury mountain quite frankly don't really want you to make that climb. They don't really invite you to their party. You're not from the neighborhood. You don't have the background."

"To make that climb up the luxury mountain you have to do things that create a forced reconsideration," he added.

<https://markets.businessinsider.com/news/stocks/warren-buffett-restoration-hardware-bets-luxury-guesthouse-lift-brand-manhattan-2019-12-1028741918>

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And Twitter is the Best Place For Unvetted Takes...



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But, What is Actually Luxury?

Luxury is a culture, which means you have to understand it to be able to practice it with flair and spontaneity. The reason why marketing – the child of the industrial society and the father of consumer power – doesn't seem to work with luxury goods the same way it does with everyday consumer goods, even top-of-the-range consumer goods, is because the two are fundamentally quite different.

Kapferer, Jean-Noël; Bastien, Vincent. The Luxury Strategy (p. 5). Kogan Page. Kindle Edition.

What is Luxury?

“Money is society’s language, luxury is its grammar...Money fuels the luxury engine but is not the engine; the engine is the recreation of vertical hierarchy or social stratification. Luxury converts the raw material that is money into a culturally sophisticated product that is social stratification.”

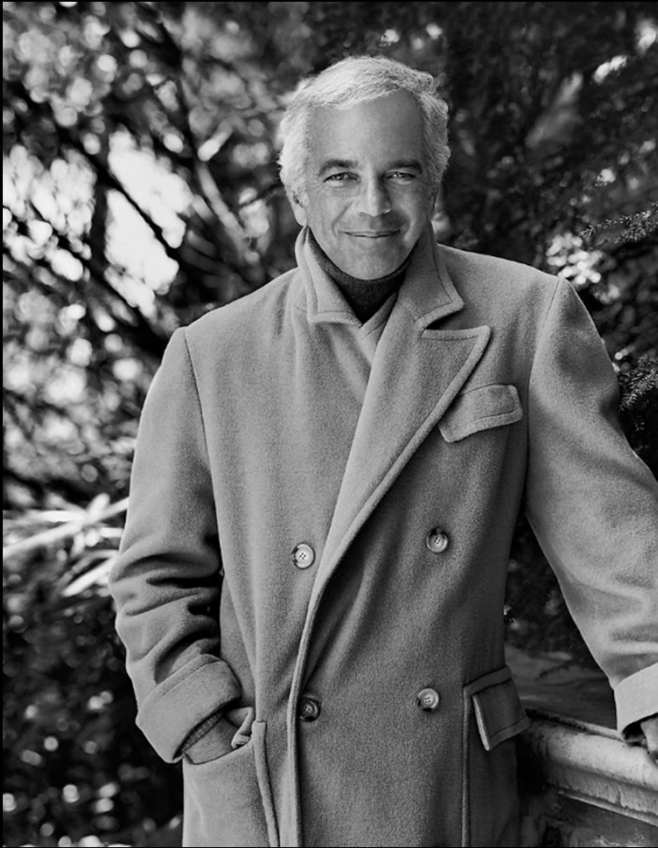
Kapferer, Jean-Noël; Bastien, Vincent. The Luxury Strategy (p. 27; 28). Kogan Page. Kindle Edition.

What is Luxury?

- Authentic
- Status Associated
- Scarce
- Produced in its country of origin
- Undiscounted
- Quality
- Unique

Kapferer, Jean-Noël; Bastien, Vincent. The Luxury Strategy. Kogan Page. Kindle Edition.

This is American Luxury!



“My goal is to bring a tradition of quality and good taste to all the places we call home.”
<https://tgr.com.ph/style-of-luxury-get-your-condo-the-look-of-a-ralph-lauren-home/>

This is Luxury Furniture Distribution

CENTURY

HOLLY HUNT

kravet®

HENREDON®

CELEBRATING
BRUNETON
MADE IN AMERICA SINCE 1926
90 YEARS

Distribution through
designers



Pictured: Chicago Merchandise Mart

Note: Designers are offered discounts off MSRP. They negotiate price with their client. There is almost no price transparency. Delivery is usually executed by third party firms. Can be quite painful and expensive.

RH

This Isn't Luxury....

Top 45 Reviews about Restoration Hardware

<https://www.consumeraffairs.com> › Homeowners ▾

★★★★★ Rating: 1.6 - 45 votes

Original review: Dec. 1, 2019. Unique products and large variety of accessories. Good place for furniture components and hardware. Like the selection of ...

Restoration Hardware Reviews | 46 Reviews of ...

<https://www.resellerratings.com> › store › Restoration_Hardware ▾

★★★★★ Rating: 1/10 - 46 reviews

46 reviews for Restoration Hardware, rated 1 stars. ... RH you're selling a premium product, which should be accompanied with a premium service. I don't care ...

And it didn't take me more than a couple of minutes to uncover the shocking truth about Restoration Hardware's "high-end" furnishings.

I mean, everyone knows (or should) that it's cheap Asian crap.

But just HOW cheap is it?

<https://laurelberninteriors.com/2016/08/10/shocking-truth-restoration-hardware/>

Restoration Hardware - 2019 All You Need to Know BEFORE ...

<https://www.yelp.com> › Shopping › Home & Garden › Hardware Stores

★★★★★ Rating: 2 - 163 reviews - Price range: \$\$\$

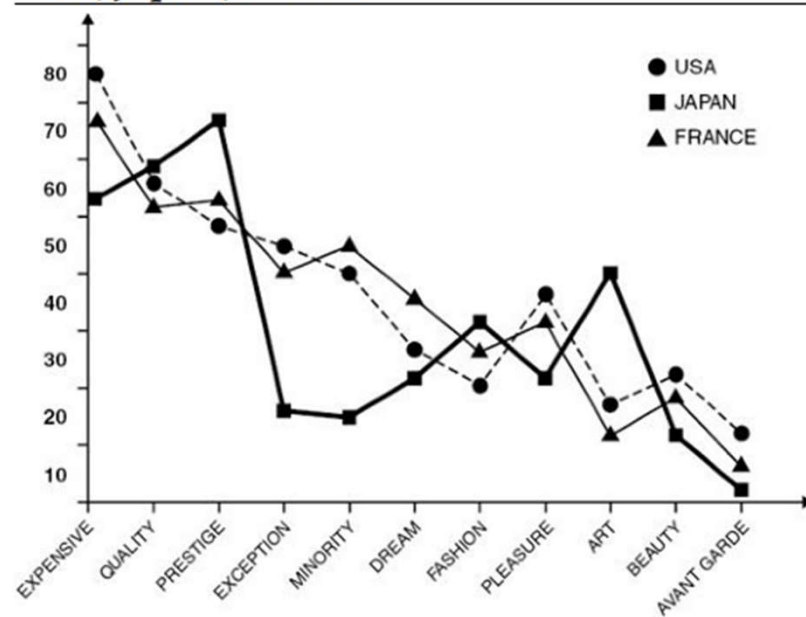
163 reviews of Restoration Hardware "I had never been in a Restoration Hardware before. You know those dystopian movies where society kills you for having ...



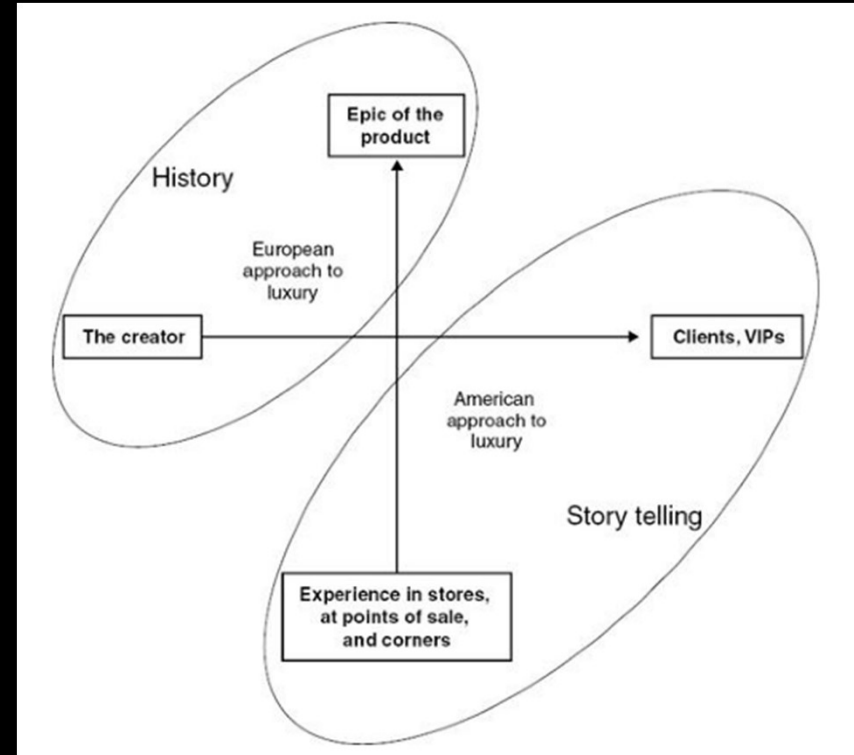
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But Stories are Important to Americans!

FIGURE 5.2 What luxury evokes in the USA, Japan, France



Kapferer, Jean-Noël; Bastien, Vincent. The Luxury Strategy (p. 125). Kogan Page. Kindle Edition.



Kapferer, Jean-Noël; Bastien, Vincent. The Luxury Strategy (p. 153). Kogan Page. Kindle Edition.

While History is Less Important

For Europeans and many Chinese too, there is not authenticity without [history]...A brand that has a true history draws an absolute prestige from it, which does not mean that it communicates only in a passéiste, traditional form...However, young people and most Americans do not have the same relationship with time: the authentic, for them, does not require vintage or historicity. It is enough to tell exciting stories, to make us dream, to give status through the people who testify to the brand's rank. Having said this, the product must be judged to be without equal.

Kapferer, Jean-Noël; Bastien, Vincent. The Luxury Strategy (p. 123). Kogan Page. Kindle Edition.

How did Ralph Do it?

“If there is no history, it must be invented. This is what modern US...brands do, since history inverts the relationship with the object and with the client: it is not a case of immediacy, but of lineage, of inheritance. Visiting any Ralph Lauren shop, you are struck by all the black-and-white photos outlining the US way of life of the 1950s...this lifestyle, these characters, these cars, these houses, these pastimes (for example polo) are themselves highly typified: a pure emanation of the closed world of the white Anglo-Saxon Protestant (WASP), far removed from that of Ralph Lifschitz, but from which he borrowed the mythology in order to create a brand and change his own name.”

Kapferer, Jean-Noël; Bastien, Vincent. The Luxury Strategy (pp. 93-94). Kogan Page. Kindle Edition.

RH's Version of Changing the Story

We're often asked by investors and analysts, how do you think about the threat of online retailers? Why do you believe your strategy of opening larger stores will succeed? ... We believe the right question to ask is this one: how many online-only retailers have reached \$1 billion in revenues and have positive net income? For the 2014 fiscal year, the answer would be two, and just barely.

Many investors and analysts are seduced by the notion of a capital-light retail strategy, and completely overlook the fact that the ongoing advertising expense to market an invisible online store is an unproven, and we believe, unsustainable model. Also interesting is when investors or companies tout their online growth rates... We know of no store-based retailer that significantly increased their operating margins by growing online faster than retail.

As we said before, it's not about physical versus digital. As A.T. Kearney eloquently put it, it's about physical with digital... Unless you're positioning yourself to be the low-price leader or you're selling replenishable commodity products, like laundry detergent, paper towels, groceries, and thousands of things that we don't sell. That's why we believe when the dust settles, our strategy of undertaking what is arguably the most significant retail store transformation in history, will prove to be the right one.

That the physical manifestation of an aspirational brand in an inspiring, three-dimensional environment, will prove to be more important than an invisible, one-dimensional online store.

-Gary Friedman 2q15 Earnings Call; 9/10/2015.

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The Physical Manifestation of RH:

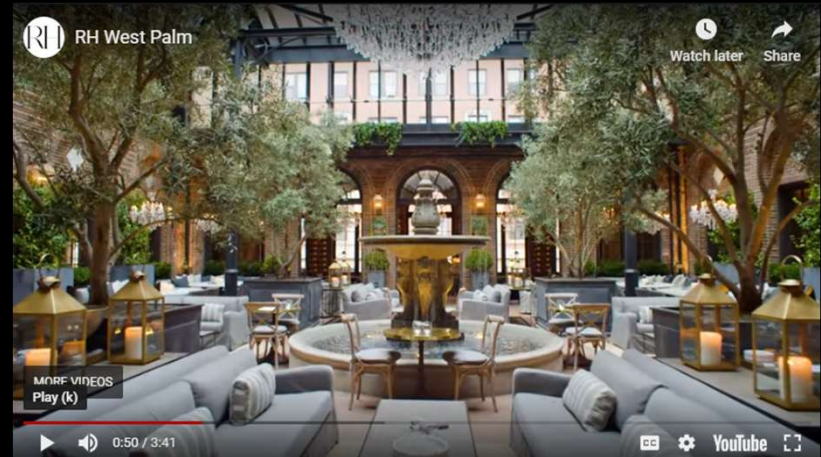


We say, we're obsessed with great architecture, that we either find it and re-adapt it or we build it, right. But why do we care about great architecture, why do we care about great buildings? Because it renders the product more valuable, it renders the product more valuable.

Gary Friedman 2017 Investor Day

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The Physical Manifestation of RH:



“There are people now that are coming to our platform that three years ago, four years ago someone who had told us they will never design for you, they will never put their product on your platform. But what's happened over the last four or five years here is we are building the most magnificent physical spaces for the best product in the world...[Now they want to work with us].”

Gary Friedman 2017 Investor Day

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The Physical Manifestation of RH:



“We are planting a flag. We are claiming a market. It's not about just year one or two or three, it is about what's going to happen in the next 10 years, how this brand is going to be perceived.”

Gary Friedman 2017 Investor Day

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The Physical Manifestation of RH:



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Scott Galloway's Take:

“I think RH is an incredible company. Talk about vision, the CEO and team there do really crazy things. As someone who knows a lot about retail, if they had toured me around the [NYC] store I would have said ‘This is fantastic and it’s never going to work.’ It’s just too expensive; too crazy. And it’s crazy until it works. The little things. Gary Friedman decided he didn’t want [liquor] in the restaurant because he didn’t want guys hitting on women because he wants women to feel like they are in a safe place. Those observations and risks [matter].”

<https://youtu.be/QNUPyBOx7Yg?t=472>

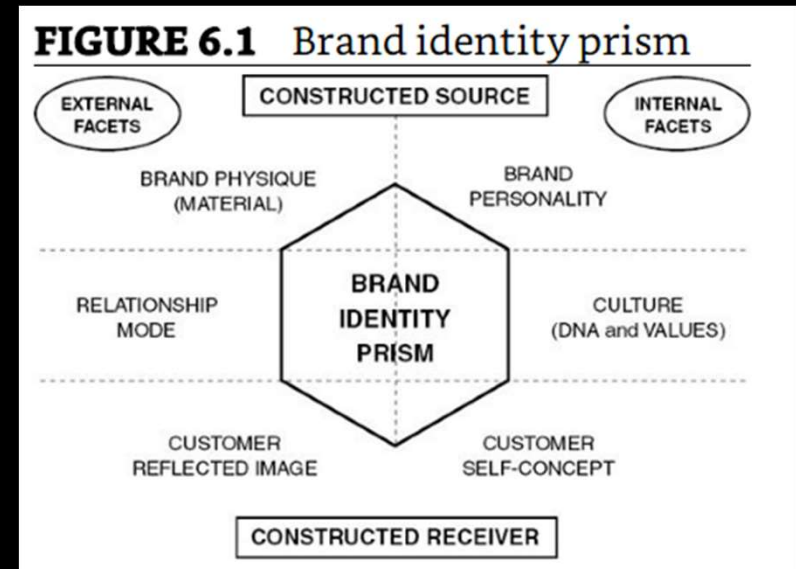
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RH is Becoming a “Whole” Rather Than a Furniture Shop

The identity of the luxury brand thus contributes to building the identity of its clients themselves. This is why the brand must be analyzed as a holistic whole: it is a cultural prism for reading the world, for creation. The identity prism (Kapferer, 2012) breaks down the symbolic dimension of brands into their six essential facets, while linking them together (see Figure 6.1).

The summit of the identity prism is that which defines the constructed source, or at least the representation thereof: what are its physical and personality traits? First, the physical aspect of the brand is the facet that makes it possible to define the family resemblance necessary within the brand: what are the codes, signs, gestures, postures, colours or traits that make up this resemblance?

Kapferer, Jean-Noël; Bastien, Vincent. *The Luxury Strategy* (p. 148). Kogan Page. Kindle Edition.



By Meaningfully Expanding its Footprint:

Retail Galleries Opened	Year Ended	Sq. Ft.		Retail Galleries Closed	Year Ended	Sq. Ft.
New York Design Gallery	2/4/2019	50,500	←	NY Flatiron Legacy Gallery	2/2/2019	21,400
Las Vegas Next Gen Design Gallery	1/31/2017	47,600		Kansas City Legacy Gallery	1/28/2017	9,900
West Palm Design Gallery	2/3/2018	46,500	←	Toronto (Yonge Street) Legacy Gallery	2/3/2018	8,600
Denver Next Generation Design Gallery	2/3/2018	46,400	←	Chicago (Lincoln Park) Legacy Gallery	2/1/2016	8,400
Nashville Design Gallery	2/3/2019	45,600	←	Seattle Legacy Gallery	1/31/2017	8,100
Chicago Next Generation Design Gallery	2/3/2019	44,800	←	Denver Legacy Gallery	2/2/2016	7,500
Toronto (Yorkdale) Design Gallery	2/3/2018	43,300	←	West Palm Legacy Gallery	2/3/2018	7,100
Austin Next Gen Design Gallery	1/30/2017	39,600	←	Nashville Legacy Gallery	2/2/2019	7,100
Tampa Next Generation Design Gallery	1/30/2017	36,100	←	San Diego Legacy Gallery	2/4/2016	6,800
Seattle Next Gen Design Gallery	2/1/2017	35,700	←	Austin Legacy Gallery	1/30/2017	6,200
Leawood Next Gen Gallery	1/28/2017	33,500	←	Tampa Legacy Gallery	1/30/2016	6,100
Portland Design Gallery	2/2/2019	26,000	←	Chicago (Deer Park) Legacy Gallery	1/31/2016	6,100
Los Angeles RH Modern	2/2/2019	12,800	←	Toronto (Bayview) Gallery	2/3/2018	6,000
Dallas RH Modern Gallery	2/6/2019	8,200	←	Pittsburg Legacy Gallery	2/1/2017	5,700
Yountville Design Gallery	2/5/2019	6,700	←	Washington DC Legacy Gallery	2/2/2019	5,600
Pittsburg Gallery	2/2/2017	6,000	←	Portland Legacy Gallery	2/2/2019	4,700
Waterworks San Francisco	1/29/2017	5,800	←	Tampa Legacy Gallery	2/3/2016	4,300
San Diego Temporary Gallery	1/29/2017	5,700	←	West Palm Baby & Child Gallery	2/3/2018	2,500
Waterworks Boston Showroom	2/3/2018	5,000	←	Waterworks Boston Gallery	2/3/2018	2,100
Portland RH Baby & Child Gallery	2/7/2019	4,700	←	Waterworks San Francisco	1/29/2017	2,000
Tampa Temporary Gallery	1/30/2016	4,300	←	Scottsdale Waterworks	2/2/2019	1,100
Greenwich RH Baby & Child	1/30/2016	4,200				
Dallas RH Baby & Child Gallery	2/8/2019	3,700				
West Palm RH Baby & Child	2/8/2019	2,500				
Total Sq. Ft. Opened		565,200		Total Sq. Ft. Closed		137,300

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Scale Changes Brought SG&A Efficiency and Gross Margin:

Investment Years

RH Economics Per Sq. Ft. (FYE)	1/28/2012	2/2/2013	2/1/2014	1/31/2015	1/30/2016	1/30/2017	2/3/2018	2/2/2019
Avg Store Count	74	72	71	68	68	77	85	83
Average Leased Selling Square Footage	589,000	508,000	526,000	572,000	641,000	802,000	930,000	1,047,000
Square Feet Per Store	7,959	7,056	7,408	8,412	9,426	10,416	10,941	12,614
Retail Sales per Leased Selling Square Footage	\$ 832.0	\$ 1,161.0	\$ 1,386.0	\$ 1,413.0	\$ 1,463.0	\$ 1,285.0	\$ 1,252.0	\$ 1,177.0
Gross Profit per Selling Square Foot	\$ 605.0	\$ 859.2	\$ 1,058.7	\$ 1,207.6	\$ 1,174.2	\$ 847.6	\$ 913.0	\$ 955.9
SG&A per Selling Square Foot	\$ 559.4	\$ 995.0	\$ 954.4	\$ 917.9	\$ 884.8	\$ 781.5	\$ 771.8	\$ 679.7
EBIT per Selling Square Foot	\$ 45.6	\$ (135.9)	\$ 104.3	\$ 289.7	\$ 289.5	\$ 66.1	\$ 141.2	\$ 276.2

Note: During the fiscal year ended 1/30/2017 RH embarked on an inventory reduction program in order to avoid the need to build another distribution center. Gross margins declined ~400bps resulting from discounting. The company also incurred \$20mm of “non-recurring” costs associated remedying customer experiences associated with rolling out RH Modern.

RH

Why Doesn't All That Square Feet Mean More Rent?

RH claims iconic locations, combined with a hospitality experience, enables the company to obtain control of locations without much capital investment via:

- Development Deals
- JVs
- “Capital light” leases

In our view, the explanations are *plausible* because we view RH as today's version of the anchor stores of past years. Those stores extracted sweet heart deals in exchange for traffic. Traffic is hard to generate these days and RH is one of the few truly desirable current retail concepts.

Development Model – Excerpts From 2018 Investor Day

All our substantial portion of the Gallery investment is returned through either this development joint venture or capital light models kind of key, if we can own these with zero capital involved or close to it, very efficient model.

Our development model is one where we – it's very capital efficient, because we're getting all our substantial portion of our investment returned through a sale leaseback. So I think it's really important to understand that this is not about owning real estate, this is about being able to use our credit, our balance sheet, our results and a sale leaseback model to get all of our money out of the Galleries. Say in the past, a typical lease model would say, you return your investment through cash flow from the Gallery. This is a strategy that allows us to really leverage the strength of our balance sheet, our operations and now the ability to sell.

Examples that we have under construction, Gary mentioned Yountville and Edina. Edina was a project that a piece of property we bought from the Simon Property Group, and we'll be opening that fall of next year. Additional projects currently in the pipeline including Detroit and this is not downtown Detroit, this is in the suburbs and Morristown, New Jersey which many of you I'm sure are familiar with, as well as Naples, Florida.

So the key benefits, it gives us the opportunity to buy and develop unique retail locations, the ability to structure the sale leasebacks with significantly lower rents. The key is we're cutting out the middleman. We don't need the capital of the developer and frankly, they don't add a lot of value when we're a key driver of great customer – high income customer traffic and we have this beautifully integrated experience like this. Going to having a developer in the middle of it, really adds no value. Their capital is more expensive than ours is. They are generating their own profits and we're able to cut that out. We can eliminate percentage rent. We – and expensive triple nets and pass-throughs and we're also

minimizing depreciation and amortization. And of course, if we have money left in development, we have to depreciate and amortize that. So, that's an earnings drag.

So model comparison, I'll give you. Edina is a quick model comparison where we're able to generate really substantial incremental cash flows under the sale leaseback model versus the typical lease model. So, what I've done here in two different columns is to say, okay, if we're to do it as a development model and I'm going to give it equal sales of \$30 million, the occupancy on our development model is about \$1.7 million versus a lease model, which is about \$2.2 million.

What are some of the key differences? The \$500,000 differences, it could be percentage rent, would be a key difference. In a sale leaseback, we will not pay percentage rent to the investor in the property. So our cash contributions are higher and therefore, our net capital in this instance is actually a positive \$3 million. I believe it will generate about a \$33 million sale price for the project and we have about \$30 million in it, which is substantially – it's a great benefit versus a lease model, we would have been out \$15 million in developing the project. Typically, in those lease models, we've been putting about [ph] 50% (00:36:21) of the capital in our sales and the developer was putting in 15%. In the new model, we – while we put up all the money, we get all the money back. Makes sense?

Potential concern: Is this sustainable long term or is it a function of yield chasing? Regardless, it's a creative way to take advantage of the market's willingness to “pay up” to have a stabilized RH property.

RH

Joint Venture Model – Excerpts From 2018 Investor Day

Yeah. So the joint venture model and I'll be available, we can ask – you can ask some questions once we get through the end of it. The joint venture model, this is interesting. This is really kind of a hybrid. This is a situation where we're able to value – to really leverage the value of an RH lease to create a joint venture or profits opportunity with minimal capital investment by RH. I'll go through a quick example, but this is typically where we can't buy it. Someone owns it, they want to do a lease with us, we come to them and say, you know, we're not going to do a lease, but if you want to participate in some of the upside and we participate as well, we'll structure a joint venture.

This is one where we contribute the value of our lease in exchange with the joint venture profits interest in the project, and our profits interest is paid upon a sale or refinancing of a project within five years or less typically. Example is Aspen, so in Aspen, we're able to secure really a prime corner in Aspen. Many of you that are familiar with it were literally catty-corner to the Ralph Lauren and across the street from the Casa Tua Restaurant. Beautiful views of Aspen Mountain, really irreplaceable real estate, that's owned and controlled by a developer in Aspen. We'll execute a lease, we'll have 40 years of control in the anchor position of the project.

We did execute, sorry about that. It's now executed. Developer contributes the property and capital to provide a build-to-suit for us with an integrated Hospitality experience. Our Hospitality experience is actually on the roof, that has like this one a beautifully – will have a glass roof on it as well as being able to open the entire restaurant to the elements of the mountains, which is beautiful including the view.

Our development pro forma project sales of about \$20 million, resulting in a return on investment within 0 to 18 months depending on the timing of the sale or refinancing. The reason I've done that is it's very possible, this project could be pre-sold. Aspen is a very attractive real estate investment venue and it's – we've generated substantial interest already in the project. We expect to generate \$8 million to \$10 million from the sale. That's our cut of the profits interest, which would give us a \$3 million to \$5 million of positive capital in the transaction.

Question: Why is RH able to pull this off? Is it because they have become a desirable tenant as hospitality drives traffic to a location? Why don't all firms do this?

RH

Capital Light Model – Excerpts From 2018 Investor Day

So I'll move onto our capital light model. And this capital light model is really a twist on the previous deals we were doing that were at lease where we're putting about 50% of the capital in and the landlord was. So based on our proof-of-concept, we've – in our improved profitability as well as the addition of Hospitality, we're now in a much more desirable and lower risk investment for a landlord.

Being able – a landlord being able to see a rooftop cafe like we have not giving up their prime first floor real estate for a restaurant, and in our proven model, it's a very nice investment for them to make. We expect that the landlord will contribute 65% to 100% of the required capital versus the previous deals where we're getting maybe 35% to 50% of the capital from the landlords. We currently have about 12 of these capital light deals in the development pipeline for 2019 and beyond.

You might ask the question why would we do capital-light deals versus just buying the property and developing it ourselves and doing sale leasebacks. In some of these projects, they'd be part of an integrated project. They could be office, residential, retail et cetera, they'll have covenants and restrictions on the properties, and frankly, those aren't as attractive to try to sell these situations. We're in a much better position of taking the landlord's capital and being able to get most of our capital out if not all.

Example of some capital light models. This is one I'm not going to disclose which one this is, but it is a...

It's a public company we dealt with and we'd be better off not stating it at this point, but our net investment is about \$8 million in this particular deal. The landlord – and this is since we captured a department store in a very key location in the center, and they are looking to redevelop it as a full expression of our age including our Gallery and a rooftop Hospitality experience. Again, in this situation we have not executed this lease yet. We'll provide 40 years of control and it – the landlord will contribute \$20 million in tenant allowance towards a total of about a \$28 million investment, and we project that we'll have about \$8 million in it, of course.

Interestingly here the land value is not included in this calculation, the previous one Edina, we actually bought the property so that's part of our capital investment. Our develop pro-forma projects that we'd return our capital within 8 months to 10 months, so a very attractive deal with the landlords providing \$20 million of the \$28 million to develop the property.

Thought: The addition of a creative, and excellent, use of underutilized space *may have* turned RH into today's version of the highly desirable anchor department stores of the past. As stated, those all got huge breaks on rent and sweetheart development deals. This isn't unprecedented. Further, Scuttlebutt suggests this thought may be accurate.

RH

The Grey Card: A Strategy, Not Simply a Membership Program

Grey Card...our strategy of moving from...[a] retail business with a primary focus of creating and selling products to an interior design platform that is conceptualizing and selling spaces.

Second, the previous promotional approach was built on a vocabulary of discounting and price, not taste, design, quality or style, and it's virtually impossible to differentiate our brand from anyone else...

The promotion activities we ran historically skewed consumer behavior and created peaks and troughs of volume from being on and off event. By smoothing out our business, we can operate in a more efficient and cost-effective manner, in our galleries, call centers, DCs, delivery hubs, throughout our supply chain and organization.

March 29, 2016, Earnings Call.

-So, RH did things like trim inventory (drop things you can get elsewhere) and focus on key product categories that drive profitable sales and enhance/distinguish the brand.

Note: The Grey Card is now “RH Members Program” but is referred to as the Grey Card in this presentation for historical context.

RH

The Grey Card: A Strategy, Not Simply a Membership Program

Luxury purchase needs time and effort to be deserved, true price and *no discounts* on excessive prices, one-to-one relationships with the salespeople and not with a machine, feeling of belonging to a 'club' of selected people and not being part of an anonymous crowd.

Kapferer, Jean-Noël; Bastien, Vincent. The Luxury Strategy (p. 83). Kogan Page. Kindle Edition.

The Grey Card: A Strategy, Not Simply a Membership Program

“I think another important point to note is the vast majority of our revenues are driven by customers who spend more than \$500 with RH. And we believe that \$100 cost to the program is set to maximize conversion. Our goal here is not to create a traditional membership program ...but to establish the best relationship with our customer and align our behavior with our brand ethos and optimize our business model.

We don't think that's possible with the old promotional cadence and it's been greatly marginalized. And while there [are] a lot of questions about how do you think about this...it is akin to the high end to the trade showrooms, who offers that discount to interior designers into the trade. And we believe the Grey Card program brings the best...experience directly to the customer...”

RH – 4Q15 Earnings Call; March 19, 2016.

RH

Fixation on a Specific Definition of Luxury Made Us Miss Change!

“‘[Gary Friedman] identified a customer who appreciates good design and doesn’t have the budget to go to an interior designer and spend \$15,000 on a couch,” said Warren Shoulberg, who covers the retail and trade furniture business...’More importantly, he’s created a physical environment that nobody else is doing in the home business that takes people off their computers and into a store where they buy more stuff.’”

Recommended Article: <https://www.forbes.com/sites/warrenshoulberg/2018/06/13/the-rh-factor-the-restorative-power-of-real-retailing/#5a236fc62535>

And We Remained Uninterested As RH Materially Improved

RH US Equity		96) Actions ▾	97) Export ▾	98) Settings	Financial Analysis		
39) ADJ	RH	ASC 842 ?			Periods 10	Annuals	Cur USD
1) Key Stats	2) I/S	3) B/S	4) C/F	5) Ratios	6) Segments	7) Addl	8) ESG
9) Custom							
11) Adjusted	12) GAAP	13) As Reported	14) Reconciliation	15) SBC & Amort	16) Adj %	17) GAAP %	
In Millions of USD except Per Share		2015 Y	2016 Y	2017 Y	2018 Y	2019 Y	Last 12M
12 Months Ending		01/31/2015	01/30/2016	01/28/2017	02/03/2018	02/02/2019	11/02/2019
Revenue		1,867.4	2,109.0	2,134.9	2,440.2	2,510.4	2,654.7
+ Sales & Services Revenue		1,867.4	2,109.0	2,134.9	2,440.2	2,510.4	2,654.7
- Cost of Revenue		1,176.6	1,339.1	1,437.8	1,584.7	1,503.3	1,572.9
+ Cost of Goods & Services		1,176.6	1,339.1	1,437.8	1,584.7	1,503.3	1,572.9
Gross Profit		690.8	769.9	697.1	855.4	1,007.1	1,081.8
+ Other Operating Income		0.0	0.0	0.0	0.0	0.0	0.0
- Operating Expenses		517.3	565.3	597.8	708.0	702.2	711.8
+ Selling, General & Admin		517.3	565.3	601.3	711.2	702.2	707.7
+ Research & Development		0.0	0.0	0.0	0.0	0.0	0.0
+ Other Operating Expense		0.0	0.0	-3.4	-3.2	0.0	4.1
Operating Income (Loss)		173.4	204.6	99.2	147.4	304.9	370.0
- Non-Operating (Income) Loss		17.6	35.7	44.5	62.6	75.1	88.4
+ Interest Expense, Net		17.6	35.7	44.5	62.1	74.2	87.9
+ Interest Expense		17.6	37.6	47.5	62.6	75.1	89.1
- Interest Income		0.1	1.9	3.0	0.5	0.8	1.2
+ Foreign Exch (Gain) Loss		0.0	0.0	0.0	0.0	0.0	0.0
+ (Income) Loss from Affiliates		—	—	—	—	—	—
+ Other Non-Op (Income) Loss		0.0	0.0	0.0	0.5	0.8	0.5
Pretax Income (Loss), Adjusted		155.9	168.9	54.8	84.9	229.8	281.6

RH

And We Remained Uninterested As RH Materially Improved

RH US Equity		96) Actions ▾	97) Export ▾	98) Settings	Financial Analysis		
39) ADJ	RH	ASC 842 ?			Periods 10	Annuals	Cur USD
1) Key Stats	2) I/S	3) B/S	4) C/F	5) Ratios	6) Segments	7) Addl	8) ESG
9) Custom							
11) Standardized	12) As Reported						
In Millions of USD except Per Share		2013 Y	2014 Y	2015 Y	2016 Y	2017 Y	2018 Y
12 Months Ending		02/02/2013	02/01/2014	01/31/2015	01/30/2016	01/28/2017	02/03/2018
Cash from Operating Activities							
+ Net Income		-12.8	18.2	91.0	91.1	5.4	2.2
+ Depreciation & Amortization		26.7	27.7	34.5	44.6	57.0	70.1
+ Non-Cash Items		68.4	106.0	9.6	47.3	107.2	148.2
+ Stock-Based Compensation		116.2	63.9	0.7	13.8	37.1	50.7
+ Deferred Income Taxes		-4.7	5.6	2.7	-6.0	-0.2	6.6
+ Other Non-Cash Adj		-43.1	36.5	6.3	39.6	70.3	90.9
+ Chg in Non-Cash Work Cap		-86.2	-64.3	-52.6	-56.3	-90.8	336.3
+ (Inc) Dec in Accts Receiv		-5.3	-5.0	-4.0	-2.6	0.6	2.8
+ (Inc) Dec in Inventories		-107.5	-100.9	-106.0	-166.5	-4.3	220.8
+ Inc (Dec) in Other		26.5	41.6	57.4	112.8	-87.0	112.8
+ Net Cash From Disc Ops		0.0	0.0	0.0	0.0	0.0	0.0
Cash from Operating Activities		-3.9	87.5	82.5	126.7	78.8	556.8
Cash from Investing Activities							
+ Change in Fixed & Intang		-49.1	-93.9	-110.8	-133.8	-158.0	-146.2

RH

Curiosity *Could* Have Been Much More Lucrative :

Because Gary Friedman told everyone what was happening on the 3/28/17 earnings call.

In many ways, we have built a brand with no peer that is disrupting the marketplace and cannot be replicated online. Yet, with all that we've done, we have three important goals to accomplish in our quest to become one of the most admired brands in the world. One, develop a backend operating platform and customer experience that matches the frontend quality of our brand; two, drive mid-teens operating margins and return on invested capital; and three, generate significant free cash flow and internally fund our growth.

Let me take a moment to put our 2016 performance into perspective, articulate our priorities for 2017 and frame our outlook for 2018 and beyond. 2016 was the year of transformation and transition. We transformed our business from a promotional to a membership model that will enhance our brand, streamline our operations and vastly improve the customer experience. We also began the transformation of our supply chain network design. As you know, we aggressively rationalized our product offer last year so we could forgo building a planned distribution center scheduled to open in 2017. We are in the process of transitioning our inventory into fewer facilities, which will simplify our business and significantly reduce working capital.

2016 was also the first full year of many new business initiatives such as RH Modern, RH Teen, RH Hospitality, the redesign of our RH Interior Source Book, the rollout of Design Ateliers, and the addition of Waterworks to our platform. All of these new initiatives are expected to contribute to growth in 2017 and beyond.

2017 will be the year of execution, architecture and cash. First, our efforts will be focused on the execution of our core RH business, our new membership model, and the new businesses introduced in 2016. We just completed the mailing

In 2017, there will be no new business investments outside of RH Hospitality, where we will have significant start-up costs to support the rollout of an integrated food and beverage experience similar to our successful gallery at the 3 Arts Club in Chicago. We expect to open five new galleries in 2017, including RH Toronto, The Gallery in Yorkdale, RH Palm Beach, The Gallery at City Place, RH New York, The Gallery in the historic Meatpacking District, RH Nashville, The Gallery in Green Hills, RH Portland, The Gallery in the Northwest historic district. Four of the new galleries, Toronto, Palm Beach, New York and Nashville, will include cafes, wine vaults and coffee bars.

Second, we plan to invest significant time in 2017, designing a new backend operating platform, inclusive of the supply chain network, the home delivery experience, a metric driven quality system, and companywide decision data. Our goal is to break down the silos that exists in most businesses of scale, and cross functionally architect a fully integrated operating platform that simplifies our business, enhances the customer experience and amplifies decision quality and speed. And third, we will have a relentless focus on maximizing cash flow and internally funding our growth.

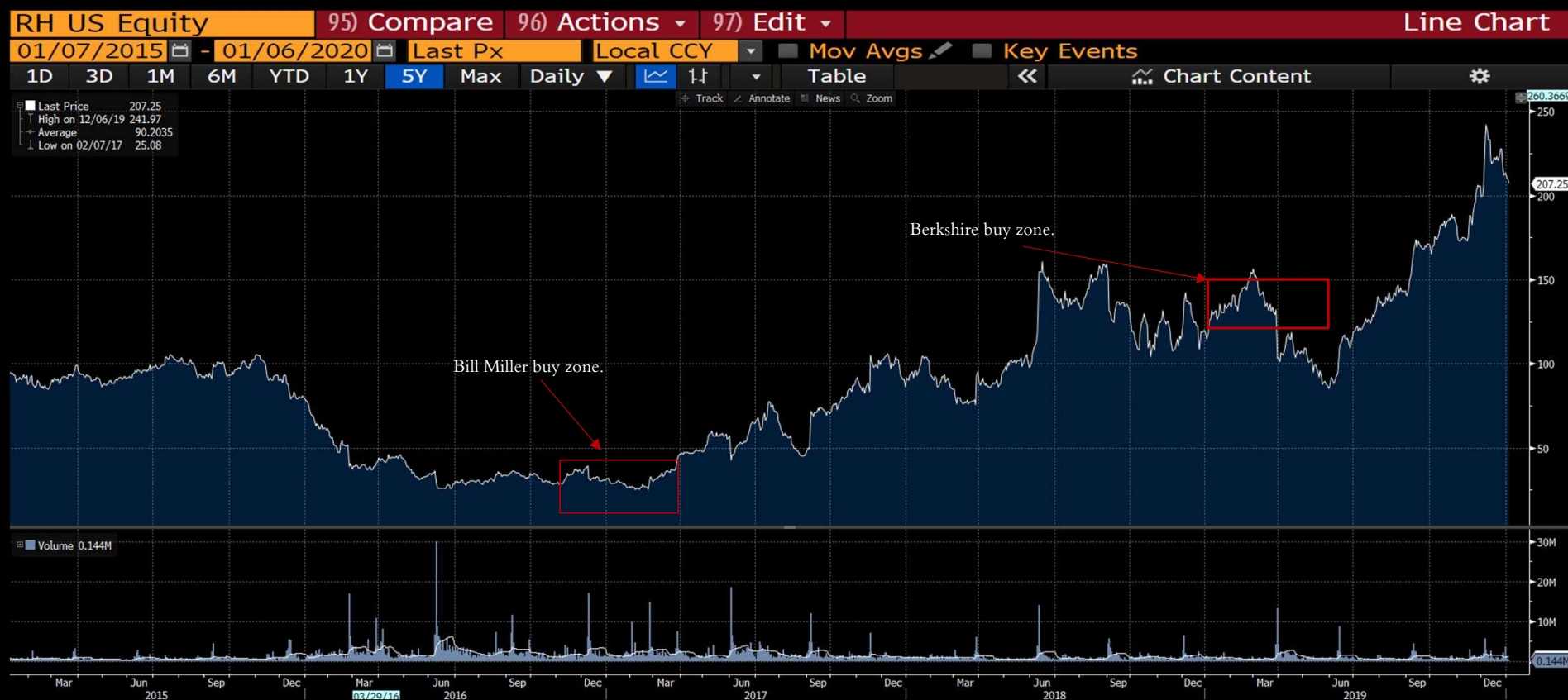
While our investment strategy will always maintain a long-term view, we believe we can improve working capital in ROIC by having a more disciplined approach to capital allocation. To that point, we now plan to open three to five new galleries per year. We believe this will result in improved deal economics, lower build out cost, and higher returns.

Additionally, the slower growth will put less pressure on the infrastructure, enabling greater capital discipline throughout the organization. As we look to 2018 and beyond, our focus will be on building the new platform, continuing to invest in long-term growth, and maximizing cash flow. Our expectation is that by the end of 2019, our new operating platform will be substantially in place and we will have one of the most dynamic new models in all of retail.

To be sure, there's a lot of hindsight bias concluding that paying attention would have resulted in seeing RH's transformation clearly. The point, however, is a closed mind never has the chance to see the world change.

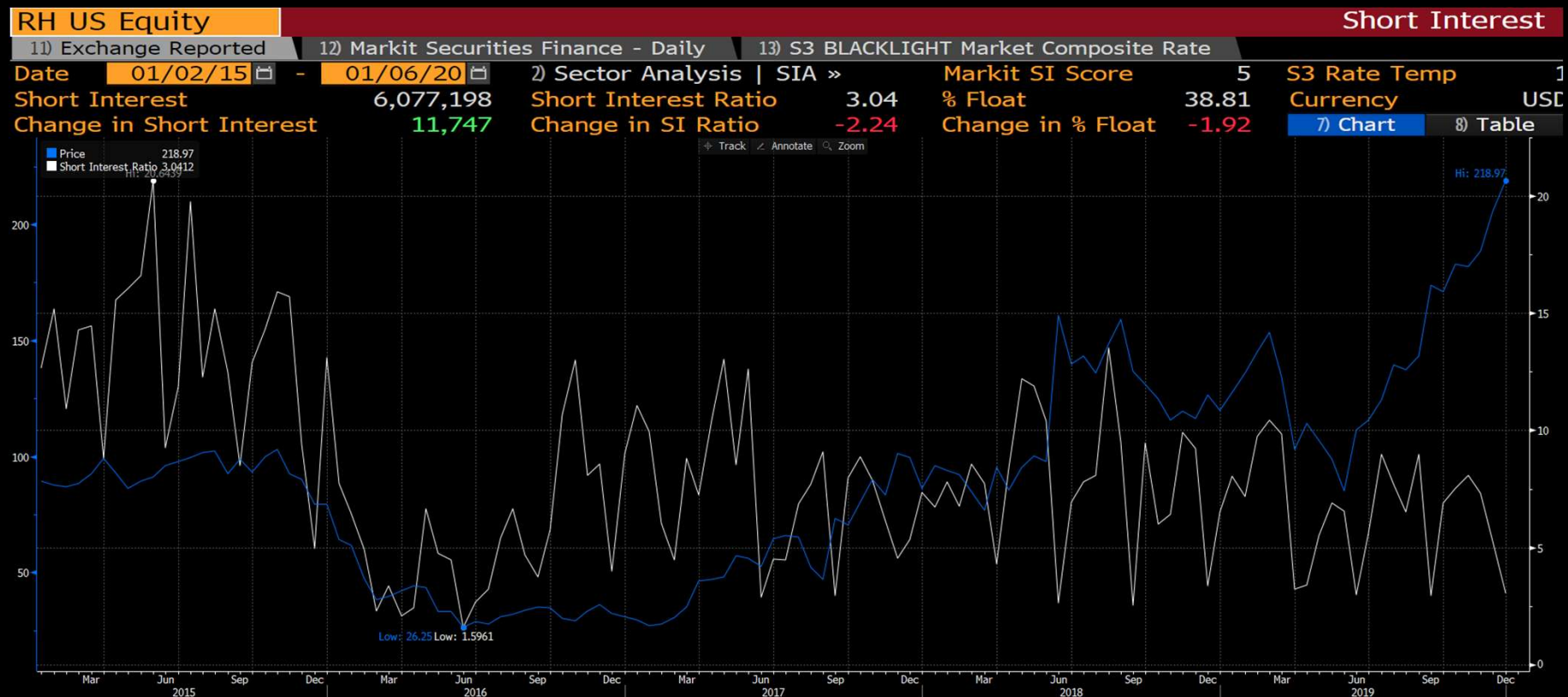
RH

Stock History:



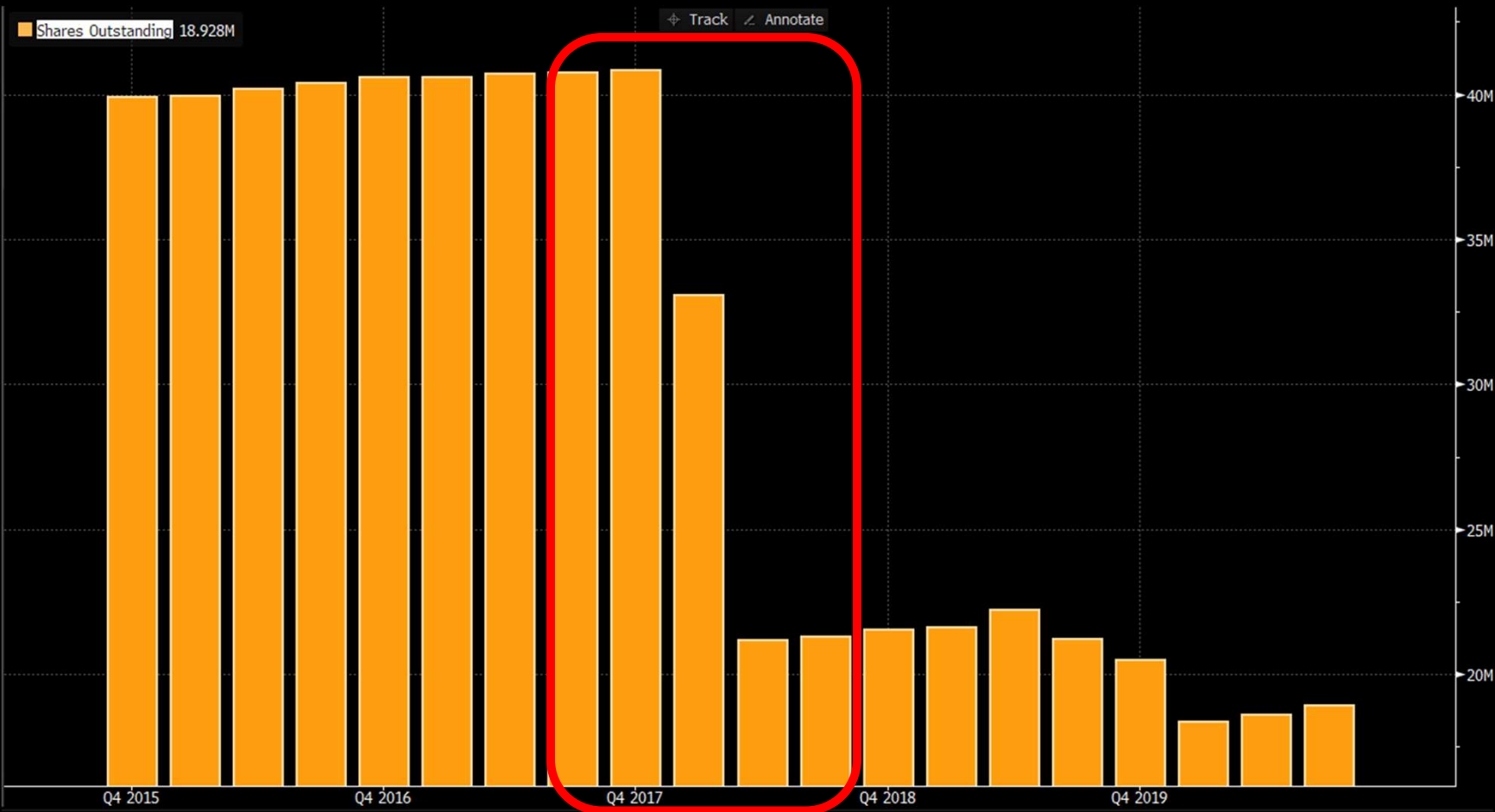
RH

Short Interest History:



RH

Share Count Reduction:



Share Count Reduction – How?

June 2014 – Issue \$350mm of 0.00% convertible notes due 2019.* (Now Retired).

June 2015 – Issue \$300mm of 0.00% convertible notes due 2020.*

February 2017 – Authorize \$300mm Repurchase Plan and *used authorization to purchase 7.8mm shares @ \$38.24/sh. By April 29.*

May 2017 – Authorize \$700mm Repurchase Plan and *used authorization to purchase 12.4mm shares @ \$56.60/sh. by July 29.*

July 2017 – Refinance credit facilities. Obtain \$600mm revolving line of credit, with a \$200mm accordion. Also obtain \$80mm last out, delayed draw term loan. Springing FCCR covenant based on liquidity test.

July 2017 – Enter 2nd Lien Term Loan for \$100mm. Contains leverage covenant of 5x debt/EBITDA. Creditor is Apollo Capital Management. Rate of LIBOR + 8.25%. (Now Retired).

June 2018 – Enter \$300mm of 0.0% convertible notes due 2023.

October 2018 – Authorized \$700mm of Share Repurchases and Repurchased \$250mm by end of 2018.

March 2019 – Replenished \$700mm Share Repurchase Authorization and Repurchased \$250mm by end of 1q20.

June 2019 – Retired June 2014 Notes in cash.

September 2019 – Retired June 2014 Notes by issuing and 42 shares and \$350mm of 0.00% convertible notes due 2024.

*Includes subsequent overallotment issues

Typical Note Structure

2015 Note Description from 6/23/15 8-K

- \$300 million of 0% convertible senior notes due 2020 at a 25% conversion premium to yesterday's closing stock price of \$94.50;
- Initial conversion rate is 8.4656 shares of common stock...which is equivalent to an initial conversion price of approximately \$118.13 per share representing a premium of 25% over yesterday's closing stock price
- Enter into convertible note hedge and warrant transactions on terms that have the effect of limiting earnings dilution... the Company's shareholders are not expected to experience earnings dilution until the Company's stock price is above approximately \$189;
- Mature on July 15, 2020, unless earlier purchased or converted;
- The notes will be convertible into cash, shares of Restoration Hardware's common stock, or a combination thereof, at Restoration Hardware's election.
- Company has no right to redeem the Notes before the Maturity Date. See Section 3.01 of Indenture.

Note Conversion Conditions

- (1) during any calendar quarter... if, for at least 20 trading days (whether or not consecutive) during the 30 consecutive trading day period ending on the last trading day of the immediately preceding calendar quarter, the last reported sale price of the Company's common stock on such trading day is greater than or equal to 130% of the applicable conversion price on such trading day;
- (2) during the five consecutive business day period after any ten consecutive trading day period in which, for each day of that period, the trading price per \$1,000 principal amount of Notes for such trading day was less than 98% of the product of the last reported sale price of the Company's common stock and the applicable Conversion Rate (See Section 10.5 of Indenture) on such trading day; or
- (3) upon the occurrence of specified corporate transactions.

Upon conversion, the Notes will be settled, at our election, in cash, shares of the Company's common stock, or a combination of cash and shares of the Company's common stock.

See 6/24/15 8-K filing and Exhibit 41 of filing.

Potential Dilution: Convertible Bond Transactions

Maturity Date	Amount	Conversion Rate	Initial Potential Dilutive Shares	Initial Conversion Price	Hedged Conversion Price	Hedged Potential Dilutive Shares	Cash Cost
7/15/2020	300,000,000	8.4656sh/\$1,000 par	2,539,680	\$ 118.13	\$ 189.00	5,100,000	\$ 44,000,000
6/15/2023	300,000,000	5.1640sh/\$1,000 par	1,549,200	\$ 193.65	\$ 309.84	3,500,000	\$ 47,200,000
9/15/2024	350,000,000	4.7304sh/\$1,000 par	1,655,640	\$ 211.40	\$ 338.24	3,300,000	\$ 46,000,000

SCG Calculations based on filings

Potential Dilution: 2020 Notes

Hypothetical Quarterly Average Share Price	Net Shares From Notes	Net Shares from Warrants	Total Dilutive Potential Shares for EPS	Net Shares From Bond Hedge	Total Expected Dilution on Maturity of Notes (in MM)
\$120	0.040		0.040	-0.040	0.000
\$130	0.232		0.232	-0.232	0.000
\$140	0.397		0.397	-0.397	0.000
\$150	0.540		0.540	-0.540	0.000
\$160	0.665		0.665	-0.665	0.000
\$170	0.775		0.775	-0.775	0.000
\$180	0.873		0.873	-0.873	0.000
\$190	0.961	0.013	0.974	-0.961	0.013
\$200	1.040	0.140	1.180	-1.040	0.140
\$210	1.111	0.254	1.365	-1.111	0.254
\$220	1.176	0.358	1.534	-1.176	0.358
\$230	1.235	0.453	1.688	-1.235	0.453
\$240	1.290	0.540	1.830	-1.290	0.540
\$250	1.340	0.620	1.960	-1.340	0.620
\$260	1.386	0.694	2.080	-1.386	0.694
\$270	1.429	0.762	2.191	-1.429	0.762
\$280	1.468	0.825	2.293	-1.468	0.825
\$290	1.505	0.885	2.390	-1.505	0.885
\$300	1.540	0.940	2.480	-1.540	0.940

<http://ir.restorationhardware.com/static-files/ffc9898e-8b4d-474b-a733-1eec197428fd>

RH

Potential Dilution: 2020 Notes

Per the 12/5/19 10-Q, RH had \$38.3mm of cash on the balance sheet and \$345.5mm of availability under its revolving credit facility. Moreover, in September, the company refinanced the notes due 2019 with similarly structured notes. Given the company's option to elect to settle the notes in cash or stock, combined with open capital markets, SCG suspects the realized dilution will prove lower than the potential dilution shown in the chart immediately preceding this slide.

RH

Potential Dilution: 2023 Notes

Hypothetical Quarterly Average Share Price	Net Shares From Notes	Net Shares from Warrants	Total Dilutive Potential Shares for EPS	Net Shares From Bond Hedge	Total Expected Dilution on Maturity of Notes (in MM)
\$190			0.000		0.000
\$200	0.055		0.055	-0.055	0.000
\$210	0.135		0.135	-0.135	0.000
\$220	0.207		0.207	-0.207	0.000
\$230	0.273		0.273	-0.273	0.000
\$240	0.334		0.334	-0.334	0.000
\$250	0.390		0.390	-0.390	0.000
\$260	0.441		0.441	-0.441	0.000
\$270	0.489		0.489	-0.489	0.000
\$280	0.534		0.534	-0.534	0.000
\$290	0.575		0.575	-0.575	0.000
\$300	0.613		0.613	-0.613	0.000
\$310	0.649	0.001	0.650	-0.649	0.001
\$320	0.683	0.055	0.738	-0.683	0.055
\$330	0.715	0.106	0.821	-0.715	0.106
\$340	0.745	0.153	0.898	-0.745	0.153
\$350	0.773	0.198	0.971	-0.773	0.198
\$360	0.799	0.241	1.040	-0.799	0.241
\$370	0.825	0.281	1.106	-0.825	0.281
\$380	0.848	0.319	1.167	-0.848	0.319
\$390	0.871	0.356	1.227	-0.871	0.356
\$400	0.892	0.390	1.282	-0.892	0.390

<http://ir.restorationhardware.com/static-files/67f59fb8-9624-45d8-92e4-f96f72a1edd>

RH

Potential Dilution: 2024 Notes

Hypothetical Quarterly Average Share Price	Net Shares From Notes	Net Shares from Warrants	Total Dilutive Potential Shares for EPS	Net Shares From Bond Hedge	Total Expected Dilution on Maturity of Notes (in MM)
\$240	0.197		0.197	-0.197	0.000
\$250	0.256		0.256	-0.256	0.000
\$260	0.309		0.309	-0.309	0.000
\$270	0.359		0.359	-0.359	0.000
\$280	0.406		0.406	-0.406	0.000
\$290	0.449		0.449	-0.449	0.000
\$300	0.489		0.489	-0.489	0.000
\$310	0.527		0.527	-0.527	0.000
\$320	0.562		0.562	-0.562	0.000
\$330	0.595		0.595	-0.595	0.000
\$340	0.626	0.009	0.635	-0.626	0.009
\$350	0.656	0.056	0.712	-0.656	0.056
\$360	0.683	0.100	0.783	-0.683	0.100
\$370	0.710	0.142	0.852	-0.710	0.142
\$380	0.735	0.182	0.917	-0.735	0.182
\$390	0.758	0.220	0.978	-0.758	0.220
\$400	0.781	0.256	1.037	-0.781	0.256
\$410	0.802	0.290	1.092	-0.802	0.290
\$420	0.822	0.322	1.144	-0.822	0.322
\$430	0.842	0.353	1.195	-0.842	0.353
\$440	0.860	0.383	1.243	-0.860	0.383
\$450	0.878	0.411	1.289	-0.878	0.411

<http://ir.restorationhardware.com/static-files/548423d0-c30f-4b9e-b97e-43debb85d4d6>

Incentives: CEO Pay, Options, and Anticipated Dilution

On May 2, 2017, the compensation committee granted a stock option to Mr. Friedman under the 2012 Stock Incentive Plan to purchase 1,000,000 shares of the Company's common stock (the "2017 Stock Option Award"), with a ten year term and an exercise price of \$50 per share, a premium to the market price for the common stock on the date of the grant.

The primary performance measure that the committee focused on for the 2017 Stock Option Award was stock price performance, which the committee determined to be a transparent and accessible measure of overall value that is easily understood by the Company's stockholders and aligns Mr. Friedman's compensation with returns experienced by investors.

The committee determined to grant the 2017 Stock Option Award as a multi-year grant to be structured as a four-year service arrangement...The compensation committee believes that the combination of time-based restrictions and performance-based restrictions tied to stock price appreciation creates a strong alignment between Mr. Friedman and the objectives of the Company's stockholders.

Incentives: CEO Pay, Options, and Anticipated Dilution

“Mr. Friedman beneficially owns 6,730,158 shares of Common Stock of the Issuer, representing beneficial ownership of **28.1% of the shares of Common Stock** outstanding as of December 12, 2019, assuming 19,044,856 shares outstanding, representing (i) 1,853,332 shares outstanding as of December 12, 2019, and (ii) 4,876,826 shares subject to options to purchase Common Stock exercisable within 60 days of December 12, 2019.”

Source: Sec 13D/A filed 12/12/19.

Gary Friedman Current Option Dilution	Exercisable	Exercise Price	Stock Price At 1/6/2020	Cash Received From Exercising Options	Value of Stock Issued	Dilution
Options Owned	2,976,826	\$ 46.50	\$ 212.77	\$ 138,422,409	\$ 633,379,268	\$ 494,956,859
	1,000,000	\$ 75.43	\$ 212.77	\$ 75,430,000	\$ 212,770,000	\$ 137,340,000
	1,000,000	\$ 50.00	\$ 212.77	\$ 50,000,000	\$ 212,770,000	\$ 162,770,000
Totals	4,976,826	\$ 53.02	\$ 212.77	\$ 263,852,409	\$ 1,058,919,268	\$ 795,066,859
Mkt Cap.	\$ 4,042,000,000					
Dilution	\$ 795,066,859					
% Dilution	16.4%					

Note: Exercisable options of 4,976,826 differ from most recent SEC Filing citing 4,876,826 options owned.

RH

Incentives: Gary Lived The Dark Days of RH; He Loves RH

“I put \$4.5 million of my own money into [RH when] everybody said [it]...was going to go bankrupt and it was the dumbest decision I could ever make...we came from that with no capital, that's where we came from, till we got to here...I actually had to sit with the accounts payable department, right, every two weeks to have them review the checks that we're going to be paid, right, the checks that we're going to be paid that pay period either to our people, our vendors, suppliers, the electric bill and then show me how much cash we brought in. And I made them add it up twice and I added it up on my calculator, because I had something that I still have today called an asset based loan. And if somebody miscalculated and had a couple checks too much go out and didn't do the math right, the whole company was going to go bankrupt, right.”

RH

Incentives: Board Compensation

	PRIOR TO JULY 18, 2018	EFFECTIVE AS OF JULY 18, 2018
Annual cash retainer	\$120,000, paid quarterly in advance	\$135,000, paid quarterly in advance
Lead Independent Director	20,000 stock options granted upon appointment ⁽¹⁾	20,000 stock options granted upon appointment and \$30,000, paid quarterly in advance
Audit committee chairman	\$50,000, paid quarterly in advance	\$80,000, paid quarterly in advance
Audit committee member	\$25,000, paid quarterly in advance	\$25,000, paid quarterly in advance
Compensation committee chairman	\$35,000, paid quarterly in advance	\$75,000, paid quarterly in advance
Compensation committee member	\$20,000, paid quarterly in advance	\$20,000, paid quarterly in advance
Nominating & corporate governance committee chairman	\$25,000, paid quarterly in advance	\$25,000, paid quarterly in advance
Nominating & corporate governance committee member	\$15,000, paid quarterly in advance	\$15,000, paid quarterly in advance
Board meeting attendance fees	\$2,500 per in-person meeting;	N/A
	\$1,500 per telephonic meeting	N/A
Annual equity grant of restricted stock	Aggregate value of \$125,000 ⁽²⁾	Aggregate value of \$125,000 ⁽²⁾

Consistent Financial Guidance/Targets

September 10, 2015

“We remain on track to reach \$4 to 5 billion in revenue with a mid-teens operating margin once our North American real estate transformation is complete...Let me remind you how we'd get there. In addition to the continued expansion of our product offer, the key to unlocking the value of our company is the transformation of our real estate. Our next-generation galleries will present six to eight times the square footage of our legacy stores, and we expect retail sales to increase two to four times in each market. The incremental square footage will allow us to fully monetize the dominate assortments we've built, and also capitalize on future category expansions and new businesses...In addition to sales growth in each market, we believe there are opportunities for significant operating margin expansion, as we experience leverage of our occupancy, advertising, and fixed corporate expenses, as well as improvement in our product and shipping margins. By the end of our real estate transformation, we see a clear path to achieving mid-teens operating margins, above our home furnishings industry peers.”

RH

Consistent Financial Guidance/Targets

June 29, 2016

“When you think about this, the opportunity to take this company to \$4 billion to \$5 billion in North America with mid-teens operating margin, that part of our strategy is fundamental, and it is working exceptionally well...There'll be some timing moves here and there. And I think that our sense is probably to be less ambitious with how fast we go...We think asset values will come down, there's going to be more and more of an opportunity for us to capitalize on that and get better deals.”

RH

Consistent Financial Guidance/Targets

November 11, 2017

“We...remain confident in long-term goal of \$4 billion to \$5 billion in North American revenues with industry-leading operating margins and return on invested capital. We believe, long term, we can grow the revenues of this company 8% to 12% a year and grow our earnings by 15% to 20% a year, and we believe we can do that for the next 10 years.”

“We also believe and believe really strongly...that the long-term opportunity for international expansion we believe is huge...We are exploring locations to open our first gallery in London. We know the location we want....It's the only one we want. It's the one we've got to get. It'll be amazing and introduce the brand in London. Terrific. It's a few years away, take us awhile just to get the real estate deal. But we think we can – the brand is highly accepted.”

RH

Consistent Financial Guidance/Targets

September 4, 2019

We clearly see \$4 billion to \$5 billion opportunity, maybe greater, in North America. But if you stand back and you look at the distribution of wealth globally...about one-third of the billionaires live in America, I think it's 15% to 20%, whichever report you look at percent of the millionaires live in the United States. And if you look at somebody's business like LVMH, right, so they have a collection of luxury brands, very large business that is well distributed globally, 25% of their business is in North America.

So, as we've been focused more on the global opportunity, we think the opportunity for RH is very, very big and it gives the confidence to put out an initial number of \$7 billion to \$10 billion. And that number is, from my point of view, very conservative, but as we look about the long-term runway and long-term sustainable growth on what we believe will be the best operating model in the industry that will be super-efficient from a capital point of view. We like where we're going, so nothing's changed.

RH

Valuation Conclusions

There is a way to find RH an attractive investment at these levels. SCG believes that requires believing the following:

- RH has a successful luxury strategy that will enable them to persistently raise prices in excess of COGS inflation. Said differently, gross margin expansion.
- The membership model and real estate strategy result in further SG&A and working capital efficiencies.
- The convertible notes can be rolled/refinanced and/or settled with minimal shares.
- RH's brand is well received internationally.

NOTE: Not Investment Advice! See Slide 2 and 3.

RH

Investment Concerns

- Is RH a fad? Perhaps, but unlikely. Gary telegraphed everything he was going to do and then executed. The stores are objectively incredible. The “physical manifestation of the brand” almost certainly permanently elevated the company. That said, the stores may be experiencing temporary, not permanent, results (especially the restaurants).
- Leverage and cyclicalities. SCG believes these risks *could* result in significant dilution. While the probability of that outcome may be small, it is not insignificant and should be carefully considered. Note: Robb & Stucky, a specialty furniture retailer, went BK in the last cycle.
- Will the brand travel? Europeans value history and traditional luxury. In our view, there will likely be some hiccups in the international expansion but success is more likely than failure.
- “Promotional CEO.” While Gary may be promotional, he backs up his talk. Or has so far...

RH

Concluding Thoughts

Close mindedness precluded the ability to see something going on around me. I live in Chicago. I've been to RH's store. I saw the change. Yet, I predetermined the brand image and didn't allow myself to see what was potentially happening. While avoiding change may be a decent evolutionary skill, it is not a lucrative skill. That said, there's no guarantee change is successful. At a minimum, I missed the enjoyment of watching and following a true transformation. It may also have cost my stakeholders a lot of money.

-Bill

Takeaway: Search for ideas in places that (a) are blatantly obvious and/or (b) make no sense. Remember to be open minded.

RH

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Podcast: Value After Hours with Tobias Carlilse and Jake Taylor.

<https://greenbackd.com/2019/12/02/s01-e01-the-value-after-hours-podcast/>



Restoration Hardware CEO and chairman Gary Friedman. Photographer: Cyrus McCrimmon/The Denver Post via Getty Images

RH