
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 8-K

**CURRENT REPORT
Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934**

Date of report (Date of earliest event reported): December 8, 2022

RH

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation)

001-35720
(Commission
File Number)

45-3052669
(I.R.S. Employer
Identification No.)

15 Koch Road, Corte Madera, California 94925
(Address of principal executive offices) (Zip Code)

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

N/A
(Former name or former address, if changed since last report.)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading symbol	Name of each exchange on which registered
Common Stock, \$0.0001 par value	RH	New York Stock Exchange

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Item 2.02. Results of Operations and Financial Condition.

On December 8, 2022, RH released its financial results for the third quarter ended October 29, 2022 in a letter to shareholders that is available on the investor relations section of its website. Copies of the press release announcing the release of financial results and the letter to shareholders are attached hereto as Exhibits 99.1 and 99.2, respectively, and are incorporated herein by reference.

The information provided in this Item 2.02, including Exhibits 99.1 and 99.2, is intended to be “furnished” and shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference into any other filing under the Securities Act of 1933, as amended (the “Securities Act”), or the Exchange Act, except as expressly set forth by specific reference in such a filing.

RH is also disclosing that it may use the rh.com, restorationhardware.com, and ir.rh.com websites as means of disclosing material non-public information and for complying with its disclosure obligations under Regulation FD.

Item 9.01. Financial Statements and Exhibits.

(d) Exhibits.

Exhibit No.	Description
99.1	Press Release dated December 8, 2022 announcing the release of third quarter 2022 results.
99.2	RH third quarter 2022 financial results and shareholder letter dated December 8, 2022.
104	Cover Page Interactive Data File—the cover page XBRL tags are embedded within the Inline XBRL document.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

RII

Dated: December 8, 2022

By: /s/ Jack Preston

Jack Preston

Chief Financial Officer

RH REPORTS THIRD QUARTER 2022 RESULTS

CORTE MADERA, Calif.--(BUSINESS WIRE)—December 8, 2022--RH (NYSE: RH) has released its financial results for the third quarter ended October 29, 2022, in a shareholder letter from Chairman and Chief Executive Officer Gary Friedman, available on the Investor Relations section of its website at ir.rh.com.

As previously announced, RH leadership will host a live conference call and audio webcast at 2:00 pm Pacific Time (5:00 pm Eastern Time) today. The conference call may be accessed by dialing 646.307.1963 or 800.715.9871 for international callers. The call and replay can also be accessed via audio webcast at ir.rh.com.

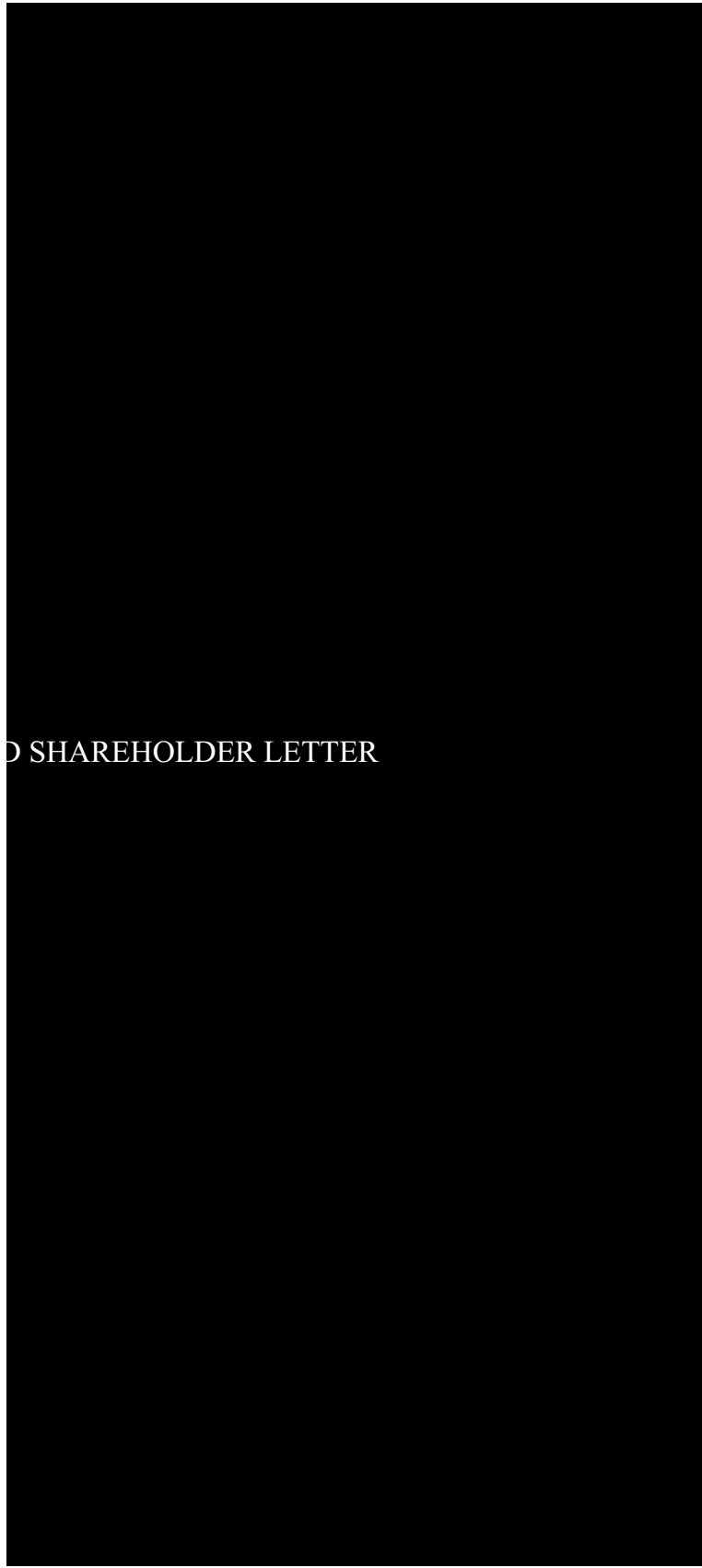
ABOUT RH

RH (NYSE: RH) is a curator of design, taste and style in the luxury lifestyle market. The Company offers collections through its retail galleries, source books, and online at RH.com, [RHContemporary](http://RHContemporary.com), RHModern.com, RHBabyandChild.com, RHTEEN.com and Waterworks.com.

CONTACTS

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D SHAREHOLDER LETTER



A LETTER FROM OUR CHAIRMAN AND CEO

RH REPORTS THIRD QUARTER RESULTS

THIRD QUARTER 2022 HIGHLIGHTS

Q3 GAAP NET REVENUES OF \$869M VS. \$1,006M LY
Q3 ADJUSTED NET REVENUES OF \$869M VS. \$1,006M LY

Q3 GAAP GROSS MARGIN OF 48.4% VS. 50.2% LY
Q3 ADJUSTED GROSS MARGIN OF 49.7% VS. 50.2% LY

Q3 GAAP OPERATING MARGIN OF 19.6% VS. 27.1% LY
Q3 ADJUSTED OPERATING MARGIN OF 20.8% VS. 27.7% LY

Q3 GAAP NET INCOME OF \$99M VS. \$184M LY
Q3 ADJUSTED NET INCOME OF \$147M VS. \$209M LY ⁽¹⁾

Q3 GAAP DILUTED EPS OF \$3.78 VS. \$5.88 LY
Q3 ADJUSTED DILUTED EPS OF \$5.67 VS. \$7.03 LY ⁽¹⁾

Please see the tables below for reconciliations of all GAAP to non-GAAP measures referenced in this press release.

(1) Adjusted net income reflects a tax rate of 0%, representing our expected cash tax liability for fiscal 2022 results. We do not expect to pay taxes for fiscal 2022 earnings due to the \$198M tax benefit from Mr. Friedman's option exercise in the first quarter. If the tax rate in the third quarter was equal to last year, adjusted net income would have been \$114M versus \$209M last year and adjusted diluted earnings per share would have been \$4.39 versus \$7.03 last year.

TO OUR PEOPLE, PARTNERS AND SHAREHOLDERS,

We are pleased to report better-than-expected results for the third quarter with net revenues of \$869 million versus \$1.006 billion a year ago and up 28% versus third quarter 2019 net revenues of \$678 million.

Gross margin contracted 50 basis points in the third quarter primarily due to fixed occupancy deleverage, partially offset by an increase in product margins as we continue to resist promoting the business.

As previously mentioned, widespread discounting continues across our industry, and while it's been almost two years since we've deployed a promotional email, we've been receiving two sale emails per day from many home furnishings retailers. Although the stark contrast in strategy may lead to a short-term risk of market share loss, we believe there is certain long-term risk of brand erosion and model destruction for those who choose the promotional path.

It's that discipline and long-term thinking that has enabled us to set new standards for financial performance in the home furnishings industry and our results now reflect those of luxury brands as we delivered a 20.8% adjusted operating margin in the third quarter, also exceeding our outlook despite the dramatic slowdown in the housing market.

Our results are inclusive of investments related to the launch of RH Contemporary, the opening of our first RH Guesthouse, the development of RH International and the rollout of RH In-Your-Home, which led to approximately 200 of the 640 basis points of adjusted SG&A deleverage in the quarter. Additionally, we experienced adjusted SG&A deleverage due to lower revenues versus a year ago.

Our business generated \$102 million of adjusted free cash flow in Q3, ending the quarter with \$2.15 billion of cash on our balance sheet, total net debt of \$375 million, and trailing twelve months adjusted EBITDA of \$1.0 billion.

FISCAL 2022 OUTLOOK

As noted in our previous shareholder letter, we expect our business trends will continue to deteriorate as a result of accelerating weakness in the housing market over the next several quarters and possibly longer due to the Federal Reserve's anticipated monetary policy and the cycling of record COVID-driven sales and backlog reductions.

Based on our current trends, we now expect fiscal 2022 revenue growth of (3.5%) to (4.5%) versus our prior outlook of (3.5%) to (5.5%), and adjusted operating margin in the range of 21.5% to 22.0% versus our prior outlook of 21.0% to 21.5%.

While we expect the next several quarters to pose a short-term challenge as we cycle the extraordinary growth from the COVID-driven spending shift and shed less valuable market share, we believe our long-term investments will enable us to continue driving industry-leading results.

RH BUSINESS VISION & ECOSYSTEM – THE LONG VIEW

We believe, "There are those with taste and no scale, and those with scale and no taste," and the idea of scaling taste is large and far reaching.

Our goal to position RH as the arbiter of taste for the home has proven to be both disruptive and lucrative, as we continue our quest to build the most admired brand in the world.

Our brand attracts the leading designers, artisans and manufacturers, scaling and rendering their work more valuable across our integrated platform, enabling RH to curate the most compelling collection of luxury home products on the planet.

Our efforts to elevate and expand our collection will continue with the introductions of RH Couture, RH Bespoke, RH Color, RH Antiques & Artifacts, RH Atelier and other new collections scheduled to launch over the next decade.

Our plan to open immersive Design Galleries in every major market will unlock the value of our vast assortment, generating revenues of \$5 to \$6 billion in North America, and \$20 to \$25 billion globally.

Our strategy is to move the brand beyond curating and selling product to conceptualizing and selling spaces, by building an ecosystem of Products, Places, Services and Spaces that establishes the RH brand as a global thought leader, taste and place maker.

Our products are elevated and rendered more valuable by our architecturally inspiring Galleries, which are further elevated and rendered more valuable by our interior design services and seamlessly integrated hospitality experience.

Our hospitality efforts will continue to elevate the RH brand as we extend beyond the four walls of our Galleries into RH Guesthouses, where our goal is to create a new market for travelers seeking privacy and luxury in the \$200 billion North American hotel industry. Additionally, we are creating bespoke experiences like RH Yountville, an integration of Food, Wine, Art & Design in the Napa Valley, RH1 and RH2, our private jets, and RH3, our luxury yacht that is available for charter in the Caribbean and Mediterranean where the wealthy and affluent visit and vacation. These immersive experiences expose new and existing customers to our evolving authority in architecture, interior design and landscape architecture.

This leads to our long-term strategy of building the world's first consumer-facing architecture, interior design and landscape architecture services platform inside our Galleries, elevating the RH brand and amplifying our core business by adding new revenue streams while disrupting and redefining multiple industries.

Our strategy comes full circle as we begin to conceptualize and sell spaces, moving beyond the \$170 billion home furnishings market into the \$1.7 trillion North American housing market with the launch of RH Residences – fully furnished luxury homes, condominiums and apartments with integrated services, that deliver taste and time value to discerning time-starved consumers.

The entirety of our strategy comes to life digitally with The World of RH, an online portal where customers can explore and be inspired by the depth and dimension of our brand.

Our authority as an arbiter of taste will be further amplified when we introduce RH Media, a content platform that will celebrate the most innovative and influential leaders who are shaping the world of architecture and design.

Our plan to expand the RH ecosystem globally multiplies the market opportunity to \$7 to \$10 trillion, one of the largest and most valuable addressed by any brand in the world today. A one percent share of the global market represents a \$70 to \$100 billion opportunity.

Our ecosystem of Products, Places, Services and Spaces inspires customers to dream, design, dine, travel and live in a world thoughtfully curated by RH, creating an emotional connection unlike any other brand in the world.

Taste can be elusive, and we believe no one is better positioned than RH to create an ecosystem that makes taste inclusive and, by doing so, elevating and rendering our way of life more valuable.

CLIMBING THE LUXURY MOUNTAIN AND BUILDING A BRAND WITH NO PEER

Every luxury brand, from Chanel to Cartier, Louis Vuitton to Loro Piana, Harry Winston to Hermès, was born at the top of the luxury mountain. Never before has a brand attempted to make the climb to the top, nor do the other brands want you to. We are not from their neighborhood, nor invited to their parties. We have a deep understanding that our work has to be so extraordinary that it creates a forced reconsideration of who we are and what we are capable of, requiring those at the top of the mountain to tip their hat in respect. We also appreciate that this climb is not for the faint of heart, and as we continue our ascent the air gets thin and the odds become slim. We believe the level of work we have introduced this year, inclusive of RH Contemporary, The World of RH, RH San Francisco, RH 1, 2, and 3, as well as the opening of our first RH Guesthouse in New York begins to demonstrate the imagination, determination, creativity and courage of this team, and our relentless pursuit of our dream.

I mentioned at the start of this year that, in over two decades leading RH, I've never been more excited about our future and I've never been more uncertain about the present. Although my uncertainty regarding the short term has expanded due to a complete collapse of the luxury housing market, my excitement for our long-term opportunity has grown exponentially as I believe the investments we are making to elevate and expand our product and platform will once again be transformative.

As we look forward to 2023, we will introduce the largest collection of new product in our history across RH Interiors, Modern, Contemporary, Outdoor, Beach & Ski House, Baby & Child, and Teen. To amplify this historic launch, we will once again unveil a revolutionary new Gallery design, as well as redesign and remodel all of our current Galleries.

We will be introducing RH to the UK and the rest of Europe this Spring/Summer in the most inspiring and unforgettable fashion with the introduction of RH England, The Gallery at the Historic Aynho Park, a 16th-century, 73-acre estate that will feature three restaurants – The Orangery, The Conservatory, and The Terrace – plus The Aynho Architectural Library and The Deer Park, inclusive of the largest herd of White Deer in Europe with viewing from the Grand Lawn.

We are also under construction on RH Paris, The Gallery on the Champs-Élysées, scheduled to open in 2024, and RH London, The Gallery in Mayfair scheduled to open in 2024-25. We have also secured locations in Milan, Madrid, Munich, Dusseldorf and Brussels, some of which will also open in 2024 and 2025.

RH also announced today the following acquisitions and hires to accelerate the brand's transformation and climb up the luxury mountain. The acquisition of Dmitriy & Co, a To-the-Trade custom upholstery atelier, and the hiring of Dmitriy founders, Donna and David Feldman, to create RH Couture Upholstery. The acquisition of the business of Jeup, Inc., a To-the-Trade custom bespoke furniture workroom, and the hiring of Joseph Jeup to create RH Bespoke Furniture. The hiring of Margaret Russell, former Editor in Chief of *Architectural Digest* and *Elle Decor*, to create RH Media, an editorial-content platform that will celebrate the most innovative and influential people and ideas that are shaping the world of architecture and design.

Today's announcements, plus our previous acquisition of Waterworks, firmly plant four RH flags at the very top of the luxury mountain, and clearly state our intention of establishing RH as an arbiter of taste and design. These brands and businesses, thoughtfully integrated and amplified on what we believe will be the world's most innovative and dynamic global design platform, will begin to fundamentally change the landscape of the luxury home furnishings market and the To-the-Trade design industry.

As we approach the holidays and new year, I would like to express our gratitude to all of our people and partners around the world for your contributions and commitment to our cause, and for bringing our vision and values to life. It's not easy striving to become the most inspiring brand in the world, and it's surely not for the faint of heart. It takes courage to lead rather than follow. It takes collaboration to build a brand that can break through the clutter in this world. It takes teamwork to reach the top of a mountain no one else has attempted to climb.

Twenty years ago we began this journey with a vision of transforming a nearly bankrupt business with a \$20 million market cap and a box of Oxydol laundry detergent on the cover of the catalog into the leading luxury home brand in the world. The lessons and learnings, the passion and persistence, the courage required, and the scar tissue developed by getting knocked down ten times and getting up eleven leads to the development of the mental and moral strength that builds character in individuals and forms cultures in organizations. Lessons that can't be learned in a classroom, or by managing a business, lessons that must be earned by building one.

Or, by reaching the top of the mountain.

Happy Holidays Team RH.

Carpe Diem,



We define “free cash flow” as net cash provided by operating activities less capital expenditures. “Adjusted free cash flow” is free cash flow inclusive of proceeds from sale of asset. Free cash flow and adjusted free cash flow are liquidity measures and are not a measure of financial performance under GAAP, and should be considered in addition to, and not as a substitute for other financial measures prepared in accordance with GAAP. Free cash flow and adjusted free cash flow are not necessarily representative of residual cash flows from the business since free cash flow and adjusted free cash flow as reported are reduced by certain cash payments made in settlement of our convertible debt upon conversion or maturity, as well as other obligations or payments made for business acquisitions.

For additional information on free cash flow, please see the Reconciliation of GAAP to non-GAAP Financial Measures tables in this press release, which include details on the GAAP financial measures that are most directly comparable to free cash flow.

NON-GAAP FINANCIAL MEASURES

To supplement its condensed consolidated financial statements, which are prepared and presented in accordance with Generally Accepted Accounting Principles (“GAAP”), the Company uses the following non-GAAP financial measures: adjusted net revenue, adjusted operating income, adjusted net income, adjusted diluted earnings per share, adjusted diluted net income per share, free cash flow, adjusted free cash flow, adjusted operating margin, adjusted gross margin, adjusted gross profit, adjusted selling, general and administrative expenses, EBITDA, adjusted EBITDA, EBITDA margin, adjusted EBITDA margin, trailing twelve months EBITDA and trailing twelve months adjusted EBITDA (collectively, “non-GAAP financial measures”). We compute these measures by adjusting the applicable GAAP measures to remove the impact of certain recurring and non-recurring charges and gains and the tax effect of these adjustments. The presentation of this financial information is not intended to be considered in isolation or as a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP. The Company uses these non-GAAP financial measures for financial and operational decision making and as a means to evaluate period-to-period comparisons. The Company believes that they provide useful information about operating results, enhance the overall understanding of past financial performance and future prospects, and allow for greater transparency with respect to key metrics used by senior leadership in its financial and operational decision making. The non-GAAP financial measures used by the Company in this release may be different from the non-GAAP financial measures, including similarly titled measures, used by other companies. For more information on the non-GAAP financial measures, please see the Reconciliation of GAAP to non-GAAP Financial Measures tables in this release. These accompanying tables include details on the GAAP financial measures that are most directly comparable to non-GAAP financial measures and the related reconciliations between these financial measures.

FORWARD-LOOKING STATEMENTS

This release contains forward-looking statements within the meaning of the federal securities laws, including without limitation, statements regarding the short-term risk of market share loss by choosing not to promote; our belief regarding the long-term risks of promotion; our expectations regarding the deterioration of our business trends as a result of accelerating weakness in the housing market; our outlook for fiscal 2022, including with respect to net revenue growth and adjusted operating margin; the next several quarters posing a short-term challenge and our plans to shed less valuable market share; our belief that our long-term investments will enable us to continue driving industry-leading results; our plans regarding the introductions of RH Couture, RH Bespoke, RH Color, RH Antiques & Artifacts, RH Atelier and other new collections scheduled to launch over the next decade; our plan to open immersive Design Galleries in every major market, generating revenues of \$5 to \$6 billion in North America, and \$20 to \$25 billion globally; our strategy to move the brand beyond curating and selling product to conceptualizing and selling spaces; our hospitality efforts continuing to elevate the RH brand as we extend into RH Guesthouses and our goal to create a new market for travelers seeking privacy and luxury in the \$200 billion North American hotel industry; our expectations with respect to RH Yountville, an integration of Food, Wine, Art & Design in the Napa Valley, RH1 and RH2, our private jets, and RH3, our luxury yacht that is available for charter in the Caribbean and Mediterranean; our long-term strategy of building the world's first consumer-facing architecture, interior design and landscape architecture services platform inside our Galleries; our strategy coming full circle as we begin to conceptualize and sell spaces with the launch of RH Residences; the entirety of our strategy coming to life digitally with The World of RH; the introduction of RH Media further amplifying our authority as an arbiter of taste; our plan to expand the RH ecosystem globally multiplying the market opportunity to \$7 to \$10 trillion; one of the largest and most valuable addressed by any brand in the world today; our ecosystem of Products, Places, Services and Spaces inspiring customers to dream, design, dine, travel and live in a world thoughtfully curated by RH, creating an emotional connection unlike any other brand in the world; our belief that no one is better positioned than RH to create an ecosystem that makes taste inclusive, elevating and rendering our way of life more valuable; our vision of transforming RH into the leading luxury home brand in the world; our belief regarding the level of work we have introduced this year beginning to demonstrate the imagination, determination, creativity and courage of this team, and our relentless pursuit of our dream; our plans as we look toward 2023, including the introduction of the largest collection of new product in our history, amplified by the unveiling of a revolutionary new Gallery design, plus redesign and remodel all of our current Galleries, the introduction of RH England, The Gallery at the Historic Aynho Park; our anticipated location openings, including RH Paris, The Gallery on the Champs-Élysées, scheduled to open in 2024, RH London, The Gallery in Mayfair scheduled to open in 2024-25, and locations in Milan, Madrid, Munich, Dusseldorf and Brussels; our expectations regarding our new hires and the acquisition of Dmitriy & Co, including that they firmly plant four RH flags at the very top of the luxury mountain and will begin to fundamentally change the landscape of the luxury home furnishing market and To-the-Trade Design industry and any statements or assumptions underlying any of the foregoing.

You can identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. These statements may include words such as "anticipate," "estimate," "expect," "project," "plan," "intend," "believe," "may," "will," "should," "likely" and other words and terms of similar meaning in connection with any discussion of the timing or nature of future events. We cannot assure you that future developments affecting us will be those that we have anticipated. All discussions of new developments are subject to inherent uncertainty as to timing and the manner in which a new development may ultimately be launched including that certain new concepts may be canceled prior to introduction. Important risks and uncertainties that could cause actual results to differ materially from our expectations include, among others, risks related to our dependence on key personnel and any changes in key personnel; successful implementation of our growth strategy; uncertainties in the current and long-term performance of our business including a range of risks related to our operations as well as external economic factors; general economic conditions and the impact on consumer confidence and spending; changes in customer demand for our products; decisions concerning the allocation of capital including the extent to which we repurchase additional shares of our common stock which will affect shares outstanding and EPS; factors affecting our outstanding indebtedness; our ability to anticipate consumer preferences and buying trends, and maintain our brand promise to customers; changes in consumer spending based on weather and other conditions beyond our control; risks related to the number of new business initiatives we are undertaking including international expansion, our real estate and Gallery development strategy and our expansion into new business areas such as hospitality; strikes and work stoppages affecting port workers and other industries involved in the transportation of our products; our ability to obtain our products in a timely fashion or in the quantities required; risks related to our sourcing and supply chain including our dependence on imported products produced by foreign manufacturers and risks related to importation of such products, risks related to the operations of our vendors, risks related to tariffs and risks related to the impact of COVID on our business; and those other risks and uncertainties disclosed under the sections entitled "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in RH's Annual Report on Form 10-K most recently filed with the Securities and Exchange Commission, and similar disclosures in subsequent reports filed with the SEC, which are available on our investor relations website at ir.rh.com and on the SEC website at www.sec.gov. You should not place undue reliance on these forward-looking statements. Any forward-looking statement made by us in this release speaks only as of the date on which we make it. RH expressly disclaims any obligation or undertaking to release publicly any updates or revisions to such statements to reflect any change in its expectations with regard thereto or any changes in the events, conditions or circumstances on which any such statement is based.

RETAIL METRICS

(Unaudited)

We operated the following number of locations:

	OCTOBER 29, 2022	OCTOBER 30, 2021
RH		
Design Galleries ⁽¹⁾	28	26
Legacy Galleries	35	36
Modern Galleries	1	1
Baby & Child and TEEN Galleries	3	3
Total Galleries	67	66
Outlets ⁽²⁾	39	38
Guesthouse ⁽¹⁾	1	—
Waterworks Showrooms	14	14

(1) As of October 29, 2022 and October 30, 2021, fifteen and twelve of our Design Galleries or Guesthouse included an integrated RH Hospitality experience, respectively.

(2) Net revenues for outlet stores were \$64 million and \$77 million for the three months ended October 29, 2022 and October 30, 2021, respectively. Net revenues for outlet stores were \$203 million and \$208 million for the nine months ended October 29, 2022 and October 30, 2021, respectively.

The following table presents RH Gallery and Waterworks Showroom metrics, and excludes Outlets:

	THREE MONTHS ENDED			
	OCTOBER 29, 2022		OCTOBER 30, 2021	
	COUNT	TOTAL LEASED SELLING SQUARE FOOTAGE <i>(in thousands)</i>	COUNT	TOTAL LEASED SELLING SQUARE FOOTAGE <i>(in thousands)</i>
Beginning of period	81	1,291	80	1,180
RH Design Galleries:				
Oak Brook Design Gallery	—	—	1	37.7
RH Legacy Galleries:				
Tysons legacy Gallery (relocation)	—	—	—	8.5
Oak Brook legacy Gallery	—	—	(1)	(10.0)
End of period	81	1,291	80	1,217
Weighted-average leased selling square footage		1,291		1,197
% growth vs. same quarter last year		8 %		3 %

See the Company's most recent Form 10-K and Form 10-Q filings for square footage definitions.

Total leased square footage as of October 29, 2022 and October 30, 2021 was approximately 1,737,000 and 1,624,000, respectively.

Weighted-average leased square footage for the three months ended October 29, 2022 and October 30, 2021 was approximately 1,737,000 and 1,600,000, respectively.

In addition, we operated one RH Guesthouse with leased square footage of approximately 24,800 square feet as of October 29, 2022.

ESTIMATED DILUTED SHARES OUTSTANDING

(Shares outstanding in millions)

ILLUSTRATIVE AVERAGE STOCK PRICES						
	Q4 2022					
Average stock price	\$ 200	\$ 250	\$ 300	\$ 350	\$ 400	\$ 450
Estimated adjusted diluted shares outstanding ⁽¹⁾	25.51	25.80	26.03	26.20	26.35	26.53
	FISCAL 2022					
Implied average stock price ⁽²⁾	\$ 276	\$ 288	\$ 301	\$ 313	\$ 326	\$ 338
Estimated adjusted diluted shares outstanding ⁽¹⁾	26.41	26.48	26.54	26.58	26.62	26.66

(1) The Q4 2022 adjusted diluted shares outstanding include 0.033 million, 0.062 million, 0.082 million, 0.098 million and 0.110 million incremental shares at \$250, \$300, \$350, \$400 and \$450 average share prices, respectively, due to dilution from the remaining convertible notes outstanding. There is immaterial dilution from the remaining convertible senior notes outstanding at the \$200 average share price for Q4 2022. The fiscal 2022 adjusted diluted shares outstanding include 0.132 million, 0.140 million, 0.147 million, 0.152 million, 0.156 million and 0.159 million incremental shares at \$276, \$288, \$301, \$313, \$326 and \$338 average share prices, respectively, due to dilution from the convertible notes and warrant agreements through the termination dates of the related bond hedge contracts in the first quarter of fiscal 2022.

(2) The implied fiscal 2022 average stock price is calculated by averaging (1) the actual average share price of \$365.86 for the three months ended April 30, 2022, (2) the actual average share price of \$271.73 for the three months ended July 30, 2022, (3) the actual average share price of \$266.31 for the three months ended October 29, 2022 and (3) an estimated average stock price for the remainder of fiscal 2022, as noted above.

Note: The table above is intended to demonstrate the impact stock prices could have on our adjusted diluted shares outstanding due to 1) additional in-the-money options, 2) the higher cost of acquired shares under the treasury stock method and 3) dilution resulting from the outstanding convertible senior notes. The table above includes the impact of the repurchase of 127,557 shares of our common stock during the three months ended October 29, 2022 under our Share Repurchase Program; however, it does not include the potential impact of future repurchases under such plan.

For adjusted dilution purposes, we will incur dilution above the strike prices of the \$335 million aggregate principal amount of convertible senior notes that were issued in June 2018 (the "2023 Notes") and the \$350 million aggregate principal amount of convertible senior notes that were issued in September 2019 (the "2024 Notes") of \$193.65 and \$211.40, respectively.

The calculation also includes assumptions around the timing and number of options exercises. Actual diluted shares outstanding may differ if actual exercises differ from estimates. The stock option awards outstanding for RH's Chairman and CEO are included in all of the adjusted diluted shares outstanding scenarios above based on the exercise prices of \$75.43, \$50.00 and \$385.30 for the July 2013, May 2017 and October 2020 grants, respectively.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	THREE MONTHS ENDED				NINE MONTHS ENDED			
	OCTOBER 29, 2022	% OF NET REVENUES	OCTOBER 30, 2021	% OF NET REVENUES	OCTOBER 29, 2022	% OF NET REVENUES	OCTOBER 30, 2021	% OF NET REVENUES
	<i>(in thousands, except per share amounts)</i>							
Net revenues	\$ 869,066	100.0 %	\$ 1,006,428	100.0 %	\$ 2,817,978	100.0 %	\$ 2,856,079	100.0 %
Cost of goods sold	448,288	51.6	501,174	49.8	1,375,399	48.8	1,456,172	51.0
Gross profit	420,778	48.4	505,254	50.2	1,442,579	51.2	1,399,907	49.0
Selling, general and administrative expenses	250,528	28.8	232,715	23.1	832,627	29.6	690,492	24.2
Income from operations	170,250	19.6	272,539	27.1	609,952	21.6	709,415	24.8
Other expenses								
Interest expense—net	31,417	3.7	13,223	1.4	78,536	2.7	40,112	1.3
Loss on extinguishment of debt	—	—	18,513	1.8	169,578	6.0	21,784	0.8
Other expense—net	1,989	0.2	—	—	4,841	0.2	—	—
Total other expenses	33,406	3.9	31,736	3.2	252,955	8.9	61,896	2.1
Income before income taxes	136,844	15.7	240,803	23.9	356,997	12.7	647,519	22.7
Income tax expense (benefit)	36,162	4.1	54,391	5.4	(70,867)	(2.5)	99,124	3.5
Income before equity method investments	100,682	11.6	186,412	18.5	427,864	15.2	548,395	19.2
Share of equity method investments losses	(1,922)	(0.2)	(2,313)	(0.2)	(6,118)	(0.2)	(6,894)	(0.2)
Net income ⁽¹⁾	\$ 98,760	11.4 %	\$ 184,099	18.3 %	\$ 421,746	15.0 %	\$ 541,501	19.0 %
Weighted-average shares used in computing basic net income per share	23,681,482		21,430,557		23,588,464		21,200,146	
Basic net income per share ⁽¹⁾	\$ 4.17		\$ 8.59		\$ 25.07		\$ 25.54	
Weighted-average shares used in computing diluted net income per share	26,098,265		31,291,079		27,255,911		31,493,396	
Diluted net income per share ⁽¹⁾	\$ 3.78		\$ 5.88		\$ 21.70		\$ 17.19	

(1) Effective the first quarter of fiscal 2022, upon adoption of *Accounting Standards Update (“ASU”) 2020-06—Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity (“ASU 2020-06”)*, the loss on extinguishment of debt related to convertible senior notes is added back to net income to calculate net income per share.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	OCTOBER 29, 2022	JANUARY 29, 2022
	<i>(in thousands)</i>	
ASSETS		
Cash, cash equivalents and restricted cash	\$ 2,154,348	\$ 2,177,889
Merchandise inventories	819,299	734,289
Other current assets	292,810	179,264
Total current assets	3,266,457	3,091,442
Property and equipment—net	1,577,900	1,227,920
Operating lease right-of-use assets	536,452	551,045
Goodwill and intangible assets	215,290	214,261
Equity method investments	97,005	100,810
Deferred tax assets and other non-current assets	190,611	354,992
Total assets	<u>\$ 5,883,715</u>	<u>\$ 5,540,470</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Accounts payable and accrued expenses	\$ 389,965	\$ 442,379
Convertible senior notes due 2023—net	1,702	9,389
Convertible senior notes due 2024	—	3,600
Deferred revenue and customer deposits	361,113	387,933
Other current liabilities	182,396	220,457
Total current liabilities	935,176	1,063,758
Asset based credit facility	—	—
Term loan B—net	1,940,701	1,953,203
Term loan B-2—net	469,396	—
Real estate loans	17,912	—
Convertible senior notes due 2023—net	—	59,002
Convertible senior notes due 2024—net	41,696	184,461
Non-current operating lease liabilities	521,093	540,513
Non-current finance lease liabilities	656,643	560,550
Other non-current obligations	7,151	8,706
Total liabilities	4,589,768	4,370,193
Stockholders' equity	1,293,947	1,170,277
Total liabilities and stockholders' equity	<u>\$ 5,883,715</u>	<u>\$ 5,540,470</u>

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	NINE MONTHS ENDED	
	OCTOBER 29, 2022	OCTOBER 30, 2021
	<i>(in thousands)</i>	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 421,746	\$ 541,501
Adjustments to reconcile net income to net cash provided by operating activities:		
Non-cash operating lease cost and finance lease interest expense	79,438	73,552
Depreciation and amortization	79,760	71,375
Stock-based compensation expense	33,725	37,426
Loss on extinguishment of debt	169,578	21,784
Asset impairments	19,080	7,354
Other non-cash items	15,348	(13,260)
Change in assets and liabilities:		
Merchandise inventories	(96,598)	(89,225)
Prepaid expenses and other current assets	(152,892)	(39,168)
Landlord assets under construction—net of tenant allowances	(43,380)	(50,351)
Deferred revenue and customer deposits	(26,604)	104,419
Other changes in assets and liabilities	(163,180)	(131,725)
Net cash provided by operating activities	<u>336,021</u>	<u>533,682</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(109,675)	(153,774)
Equity method investments	(2,313)	(4,816)
Proceeds from sale of asset	5,287	—
Net cash used in investing activities	<u>(106,701)</u>	<u>(158,590)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings under term loans	485,000	2,000,000
Net borrowings under real estate loans	15,996	—
Repayment under convertible senior notes repurchase obligation	(395,372)	—
Debt issuance costs	(27,733)	(26,411)
Repayments of convertible senior notes	(13,053)	(235,126)
Proceeds from termination of convertible senior note hedges	231,796	—
Payments for termination of common stock warrants	(390,934)	—
Repurchases of common stock—including commissions	(286,441)	—
Proceeds from exercise of stock options	153,568	30,080
Other financing activities	(28,508)	(47,029)
Net cash provided by (used in) financing activities	<u>(255,681)</u>	<u>1,721,514</u>
Effects of foreign currency exchange rate translation	(1,155)	34
Net increase (decrease) in cash and cash equivalents, restricted cash and restricted cash equivalents	<u>(27,516)</u>	<u>2,096,640</u>
Cash and cash equivalents, restricted cash and restricted cash equivalents		
Beginning of period—cash and cash equivalents	2,177,889	100,446
Beginning of period—restricted cash equivalents (acquisition related escrow deposits)	3,975	6,625
Beginning of period—cash and cash equivalents	<u>\$ 2,181,864</u>	<u>\$ 107,071</u>
End of period—cash and cash equivalents		
End of period—cash and cash equivalents	2,150,466	2,198,961
End of period—restricted cash	3,882	—
End of period—restricted cash equivalents (acquisition related escrow deposits)	—	4,750
End of period—cash and cash equivalents, restricted cash and restricted cash equivalents	<u>\$ 2,154,348</u>	<u>\$ 2,203,711</u>

CALCULATION OF FREE CASH FLOW AND ADJUSTED FREE CASH FLOW

(Unaudited)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	OCTOBER 29, 2022	OCTOBER 30, 2021	OCTOBER 29, 2022	OCTOBER 30, 2021
	<i>(in thousands)</i>			
Net cash provided by operating activities	\$ 143,505	\$ 216,964	\$ 336,021	\$ 533,682
Capital expenditures	(47,117)	(71,636)	(109,675)	(153,774)
Free cash flow ⁽¹⁾⁽³⁾	96,388	145,328	226,346	379,908
Proceeds from sale of asset	5,287	—	5,287	—
Adjusted free cash flow ⁽²⁾⁽³⁾	\$ 101,675	\$ 145,328	\$ 231,633	\$ 379,908

- (1) Free cash flow is net cash provided by operating activities less capital expenditures. Free cash flow for the three and nine months ended October 30, 2021 includes the effect of \$34 million and \$39 million, respectively, relating to the portion of repayments of convertible senior notes attributable to debt discount upon settlement (such portion of the debt settlement reduces net cash provided by operating activities in the reported period). We adopted ASU 2020-06 as of the first quarter of fiscal 2022. No amortization of the debt discounts were recognized during the three or nine months ended October 29, 2022 since we recombined the previously outstanding equity component of the 2023 Notes and 2024 Notes upon the adoption of ASU 2020-06, which resulted in an increase in the balance of convertible debt outstanding.
- (2) Adjusted free cash flow is free cash flow inclusive of proceeds from sale of asset.
- (3) Free cash flow and adjusted free cash flow are non-GAAP financial measures and are included in this shareholder letter because we believe that these measures provide useful information to our senior leadership team and investors in understanding the strength of our liquidity and our ability to generate additional cash from our business operations. Free cash flow and adjusted free cash flow should not be considered in isolation or as an alternative to cash flows from operations calculated in accordance with GAAP, and should be considered alongside our other liquidity performance measures that are calculated in accordance with GAAP, such as net cash provided by operating activities and our other GAAP financial results. Our senior leadership team uses these non-GAAP financial measures in order to have comparable financial results for the purpose of analyzing changes in our underlying business from quarter to quarter. Our measures of free cash flow and adjusted free cash flow are not necessarily comparable to other similarly titled measures for other companies due to different methods of calculation.

CALCULATION OF ADJUSTED CAPITAL EXPENDITURES

(Unaudited)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	OCTOBER 29, 2022	OCTOBER 30, 2021	OCTOBER 29, 2022	OCTOBER 30, 2021
	<i>(in thousands)</i>			
Capital expenditures	\$ 47,407	\$ 71,636	\$ 109,965	\$ 153,774
Landlord assets under construction—net of tenant allowances	11,782	6,999	44,242	50,351
Adjusted capital expenditures ⁽¹⁾	\$ 59,189	\$ 78,635	\$ 154,207	\$ 204,125

- (1) We define adjusted capital expenditures as capital expenditures from investing activities and cash outflows of capital related to construction activities to design and build landlord-owned leased assets, net of tenant allowances received during the construction period.

RECONCILIATION OF GAAP NET INCOME TO ADJUSTED NET INCOME

(Unaudited)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	OCTOBER 29, 2022	OCTOBER 30, 2021	OCTOBER 29, 2022	OCTOBER 30, 2021
	<i>(in thousands)</i>			
GAAP net income	\$ 98,760	\$ 184,099	\$ 421,746	\$ 541,501
Adjustments (pre-tax):				
Cost of goods sold:				
Asset impairments ⁽¹⁾	10,926	—	10,926	—
Selling, general and administrative expenses:				
Non-cash compensation ⁽²⁾	4,136	5,831	14,315	17,559
Employer payroll taxes on option exercise ⁽³⁾	—	—	11,717	—
Asset impairments ⁽¹⁾	—	—	8,154	7,354
Professional fees ⁽⁴⁾	—	—	7,469	—
Compensation settlements ⁽⁵⁾	—	—	3,483	—
Recall accrual ⁽⁶⁾	—	340	560	840
Legal settlements ⁽⁷⁾	(4,188)	—	(4,188)	—
Gain on sale of building and land ⁽⁸⁾	(775)	—	(775)	—
Reorganization related costs ⁽⁹⁾	—	—	—	449
Other expenses:				
Loss on extinguishment of debt ⁽¹⁰⁾	—	18,513	169,578	21,784
Gain on derivative instruments—net ⁽¹¹⁾	—	—	(1,724)	—
Amortization of debt discount ⁽¹²⁾	—	4,023	—	15,869
Subtotal adjusted items	10,099	28,707	219,515	63,855
Impact of income tax items ⁽¹³⁾	36,162	(6,518)	(70,867)	(9,774)
Share of equity method investments losses ⁽¹⁴⁾	1,922	2,313	6,118	6,894
Adjusted net income ⁽¹⁵⁾	\$ 146,943	\$ 208,601	\$ 576,512	\$ 602,476

- (1) The adjustments to cost of goods sold in the three and nine months ended October 29, 2022 represent inventory impairment. The adjustment to selling, general and administrative expense in the nine months ended October 29, 2022 includes asset impairment related to property and equipment of Galleries under construction, as well as lease impairment of \$1.0 million due to the early exit of a leased facility. The adjustment to selling, general and administrative expense in the nine months ended October 30, 2021 represents asset impairments.
- (2) Represents the amortization of the non-cash compensation charge related to a fully vested option grant made to Mr. Friedman in October 2020.
- (3) Represents employer payroll tax expense related to the option exercise by Mr. Friedman in the first quarter of fiscal 2022.
- (4) Represents professional fees contingent upon the completion of certain transactions related to the 2023 Notes and 2024 Notes, including bond hedge and warrant terminations and convertible senior notes repurchases.
- (5) Represents compensation settlements related to the Rollover Units and Profit Interest Units in the Waterworks subsidiary.
- (6) Represents accruals associated with product recalls.
- (7) Represents a favorable legal settlement associated with a lease arrangement.
- (8) Represents gain on sale of building and land.

- (9) Represents severance costs and related payroll taxes associated with reorganizations.
- (10) The adjustment in the nine months ended October 29, 2022 represents a loss on extinguishment of debt related to the repurchase of \$237 million of principal value of convertible senior notes, inclusive of the acceleration of amortization of debt issuance costs of \$1.3 million. The adjustment in each of the three and nine months ended October 30, 2021 represent the loss on extinguishment of debt for a portion of the 2023 Notes that were early converted at the option of the noteholders.
- (11) Represents net gain on derivative instruments resulting from certain transactions related to the 2023 Notes and 2024 Notes, including bond hedge and warrant terminations and convertible senior notes repurchases.
- (12) Prior to the adoption of ASU 2020-06, certain convertible debt instruments that may be settled in cash on conversion were required to be separately accounted for as liability and equity components of the instrument in a manner that reflected the issuer's non-convertible debt borrowing rate. Accordingly, in accounting for GAAP purposes through fiscal 2021 for the 2023 Notes and the 2024 Notes, we separated the 2023 Notes and 2024 Notes into liability (debt) and equity (conversion option) components and we amortized as debt discount an amount equal to the fair value of the equity components as interest expense on the 2023 Notes and 2024 Notes over their expected lives. The equity components represented the difference between the proceeds from the issuance of the 2023 Notes and 2024 Notes and the fair value of the liability components of the 2023 Notes and 2024 Notes, respectively. Amounts were presented net of interest capitalized for capital projects of \$2.8 million and \$8.4 million during the three and nine months ended October 30, 2021, respectively. No amortization of the debt discounts were recognized during the three and nine months ended October 30, 2022, since we recombined the previously outstanding equity component of the 2023 Notes and 2024 Notes upon the adoption of ASU 2020-06.
- (13) The adjustment for the three and nine months ended October 30, 2021 is based on adjusted tax rates of 22.6% and 15.3%, respectively, which exclude the tax impact associated with our share of equity method investments losses. The adjustment for both the three and nine months ended October 29, 2022 is based on an adjusted tax rate of 0.0%, which represents our expected cash tax liability associated with anticipated fiscal 2022 results as we do not expect to pay taxes for fiscal 2022 due to the tax benefits primarily resulting from Mr. Friedman's option exercise in the first quarter of fiscal 2022. If the tax rate for the three months ended October 29, 2022 was equal to the adjusted tax rate for the three months ended October 30, 2021 of 22.6%, adjusted net income (*in thousands*) and net income per share would have been as follows:

	REVISED ADJUSTED NET INCOME ^(a)	IMPACT TO ADJUSTED NET INCOME PER SHARE ^(b)
GAAP net income	\$ 98,760	\$ 3.81
Subtotal adjusted items	10,099	0.39
Impact of income tax items	2,953	0.12
Share of equity method investments losses	1,922	0.07
Adjusted net income	\$ 113,734	\$ 4.39

- (a) Refer to table titled "Reconciliation of GAAP Net Income to Adjusted Net Income" and the related footnotes for additional information.
- (b) Refer to table titled "Reconciliation of Diluted Net Income Per Share to Adjusted Diluted Net Income Per Share" and the related footnotes for additional information.
- (14) Represents our proportionate share of the losses of our equity method investments.
- (15) Adjusted net income is a supplemental measure of financial performance that is not required by, or presented in accordance with, GAAP. We define adjusted net income as consolidated net income, adjusted for the impact of certain non-recurring and other items that we do not consider representative of our underlying operating performance. Adjusted net income is included in this shareholder letter because our senior leadership team believes that adjusted net income provides meaningful supplemental information for investors regarding the performance of our business and facilitates a meaningful evaluation of operating results on a comparable basis with historical results. Our senior leadership team uses this non-GAAP financial measure in order to have comparable financial results to analyze changes in our underlying business from quarter to quarter.

RECONCILIATION OF DILUTED NET INCOME PER SHARE TO
ADJUSTED DILUTED NET INCOME PER SHARE

(Unaudited)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	OCTOBER 29, 2022	OCTOBER 30, 2021	OCTOBER 29, 2022	OCTOBER 30, 2021
Diluted net income per share	\$ 3.78	\$ 5.88	\$ 21.70	\$ 17.19
Pro forma diluted net income per share ⁽¹⁾⁽²⁾⁽³⁾	\$ 3.81	\$ 6.21	\$ 22.14	\$ 18.37
Per share impact of adjustments (pre-tax) ⁽⁴⁾ :				
Asset impairments	0.42	—	0.71	0.25
Non-cash compensation	0.16	0.20	0.54	0.60
Employer payroll taxes on option exercise	—	—	0.44	—
Professional fees	—	—	0.28	—
Compensation settlements	—	—	0.13	—
Recall accrual	—	0.01	0.02	0.03
Legal settlements	(0.16)	—	(0.16)	—
Gain on derivative instruments—net	—	—	(0.06)	—
Gain on sale of building and land	(0.03)	—	(0.03)	—
Loss on extinguishment of debt ⁽⁵⁾	—	0.62	—	0.74
Amortization of debt discount	—	0.14	—	0.54
Reorganization related costs	—	—	—	0.01
Subtotal adjusted items	0.39	0.97	1.87	2.17
Impact of income tax items ⁽⁴⁾	1.40	(0.22)	(2.66)	(0.33)
Share of equity method investments losses ⁽⁴⁾	0.07	0.07	0.23	0.23
Adjusted diluted net income per share ⁽⁶⁾	\$ 5.67	\$ 7.03	\$ 21.58	\$ 20.44

- (1) For the three months ended October 29, 2022, subsequent to the adoption of ASU 2020-06, for GAAP purposes, we incur dilution for the principal of the convertible notes assuming the if-converted method, however, we exclude from our adjusted diluted shares outstanding calculation the dilutive impact of the principal value of the convertible notes. Pro forma diluted net income per share for the three months ended October 29, 2022 is calculated based on GAAP net income and pro forma diluted weighted-average shares of 25,934,498, which excludes dilution of 163,767 shares related to the 2023 Notes and 2024 Notes.
- (2) For the nine months ended October 29, 2022, subsequent to the adoption of ASU 2020-06, for GAAP purposes, we incur dilution (i) for the principal of the convertible notes assuming the if-converted method and (ii) above the lower strike prices of the 2023 Notes and 2024 Notes of \$193.65 and \$211.40, respectively, through the termination dates of the related bond hedge contracts in the first quarter of fiscal 2022. However, we exclude from our adjusted diluted shares outstanding calculation (i) the dilutive impact of the principal value of the convertible notes and (ii) the dilutive impact of the convertible notes between \$193.65 and \$309.84 for the 2023 Notes and between \$211.40 and \$338.24 for our 2024 Notes, based on the bond hedge contracts that were in place and would have delivered shares to offset dilution in these ranges through the termination date of such contracts in the first quarter of fiscal 2022. At stock prices in excess of \$309.84 and \$338.24 through the termination dates of the related bond hedge contracts in the first quarter of fiscal 2022, we incurred dilution related to the 2023 Notes and 2024 Notes, respectively, and we would have had an obligation to deliver additional shares in excess of the dilution protection provided by the bond hedges. Pro forma diluted net income per share for the nine months ended October 29, 2022 is calculated based on GAAP net income and pro forma diluted weighted-average shares of 26,709,075, which excludes dilution of 546,836 shares related to the 2023 Notes and 2024 Notes.

- (3) For the three and nine months ended October 30, 2021, prior to the adoption of ASU 2020-06, for GAAP purposes, we incurred dilution above the lower strike prices of the 2023 Notes and 2024 Notes of \$193.65 and \$211.40, respectively. However, we excluded from our adjusted diluted shares outstanding calculation the dilutive impact of the convertible notes between \$193.65 and \$309.84 for the 2023 Notes and between \$211.40 and \$338.24 for our 2024 Notes, based on the bond hedge contracts that were in place and would have delivered shares to offset dilution in these ranges. At stock prices in excess of \$309.84 and \$338.24, we incurred dilution related to the 2023 Notes and 2024 Notes, respectively, and we would have had an obligation to deliver additional shares in excess of the dilution protection provided by the bond hedges. Pro forma diluted net income per share for the three months ended October 30, 2021 is calculated based on GAAP net income and pro forma diluted weighted-average shares of 29,666,353, which excludes dilution related to the 2023 Notes and 2024 Notes of 1,624,726 shares. Pro forma diluted net income per share for the nine months ended October 30, 2021 is calculated based on GAAP net income and pro forma diluted weighted-average shares of 29,471,139, which excludes dilution of 2,022,257 shares related to the 2023 Notes and 2024 Notes.
- (4) Refer to table titled “Reconciliation of GAAP Net Income to Adjusted Net Income” and the related footnotes for additional information.
- (5) Effective the first quarter of fiscal 2022 upon adoption of ASU 2020-06, the loss on extinguishment of debt related to convertible securities is added back to net income to calculate net income per share. Accordingly, no reconciliation adjustments are required for the three and nine months ended October 29, 2022 as the impact of the loss on extinguishment of debt for these periods is included in pro forma diluted net income per share.
- (6) Adjusted diluted net income per share is a supplemental measure of financial performance that is not required by, or presented in accordance with, GAAP. We define adjusted diluted net income per share as consolidated net income, adjusted for the impact of certain non-recurring and other items that we do not consider representative of our underlying operating performance divided by our pro forma share count. Adjusted diluted net income per share is included in this shareholder letter because our senior leadership team believes that adjusted diluted net income per share provides meaningful supplemental information for investors regarding the performance of our business and facilitates a meaningful evaluation of operating results on a comparable basis with historical results. Our senior leadership team uses this non-GAAP financial measure in order to have comparable financial results to analyze changes in our underlying business from quarter to quarter.

RECONCILIATION OF GROSS PROFIT TO ADJUSTED GROSS PROFIT

(Unaudited)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	OCTOBER 29, 2022	OCTOBER 30, 2021	OCTOBER 29, 2022	OCTOBER 30, 2021
	<i>(dollars in thousands)</i>			
Net revenues	\$ 869,066	\$ 1,006,428	\$ 2,817,978	\$ 2,856,079
Gross profit	\$ 420,778	\$ 505,254	\$ 1,442,579	\$ 1,399,907
Asset impairments ⁽¹⁾	10,926	—	10,926	—
Adjusted gross profit ⁽²⁾	\$ 431,704	\$ 505,254	\$ 1,453,505	\$ 1,399,907
Gross margin ⁽³⁾	48.4 %	50.2 %	51.2 %	49.0 %
Adjusted gross margin ⁽³⁾	49.7 %	50.2 %	51.6 %	49.0 %

- (1) Refer to table titled “Reconciliation of GAAP Net Income to Adjusted Net Income” and the related footnotes for additional information.
- (2) Adjusted gross profit is a supplemental measure of financial performance that are not required by, or presented in accordance with, GAAP. We define adjusted gross profit as consolidated gross profit, adjusted for the impact of certain non-recurring and other items that we do not consider representative of our underlying operating performance. Adjusted gross profit is included in this shareholder letter because our senior leadership team believes that adjusted gross profit provide meaningful supplemental information for investors regarding the performance of our business and facilitate a meaningful evaluation of operating results on a comparable basis with historical results. Our senior leadership team uses these non-GAAP financial measures in order to have comparable financial results to analyze changes in our underlying business from quarter to quarter.
- (3) Gross margin is defined as gross profit divided by net revenues. Adjusted gross margin is defined as adjusted gross profit divided by net revenues.

RECONCILIATION OF SELLING, GENERAL AND ADMINISTRATIVE EXPENSES TO
ADJUSTED SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

(Unaudited)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	OCTOBER 29, 2022	OCTOBER 30, 2021	OCTOBER 29, 2022	OCTOBER 30, 2021
	<i>(dollars in thousands)</i>			
Selling, general and administrative expenses	\$ 250,528	\$ 232,715	\$ 832,627	\$ 690,492
Non-cash compensation ⁽¹⁾	4,136	5,831	14,315	17,559
Employer payroll taxes on option exercise ⁽¹⁾	—	—	11,717	—
Asset impairments ⁽¹⁾	—	—	8,154	7,354
Professional fees ⁽¹⁾	—	—	7,469	—
Compensation settlements ⁽¹⁾	—	—	3,483	—
Recall accrual ⁽¹⁾	—	340	560	840
Legal settlements ⁽¹⁾	(4,188)	—	(4,188)	—
Gain on sale of building and land ⁽¹⁾	(775)	—	(775)	—
Reorganizational related costs ⁽¹⁾	—	—	—	449
Adjusted selling, general and administrative expenses ⁽²⁾	\$ 251,355	\$ 226,544	\$ 791,892	\$ 664,290
Net revenues	\$ 869,066	\$ 1,006,428	\$ 2,817,978	\$ 2,856,079
Selling, general and administrative expenses margin ⁽³⁾	28.8 %	23.1 %	29.6 %	24.2 %
Adjusted selling, general and administrative expenses margin ⁽³⁾	28.9 %	22.5 %	28.1 %	23.3 %

- (1) Refer to table titled “Reconciliation of GAAP Net Income to Adjusted Net Income” and the related footnotes for additional information.
- (2) Adjusted selling, general and administrative expenses is a supplemental measure of financial performance that is not required by, or presented in accordance with, GAAP. We define adjusted selling, general and administrative expenses as consolidated selling, general and administrative expenses, adjusted for the impact of certain non-recurring and other items that we do not consider representative of our underlying operating performance. Adjusted selling, general and administrative expenses is included in this shareholder letter because our senior leadership team believes that adjusted selling, general and administrative expenses provides meaningful supplemental information for investors regarding the performance of our business and facilitates a meaningful evaluation of operating results on a comparable basis with historical results. Our senior leadership team uses this non-GAAP financial measure in order to have comparable financial results to analyze changes in our underlying business from quarter to quarter.
- (3) Selling, general and administrative expenses margin is defined as selling, general and administrative expenses divided by net revenues. Adjusted selling, general and administrative expenses margin is defined as adjusted selling, general and administrative expenses divided by net revenues.

RECONCILIATION OF NET INCOME TO OPERATING INCOME
AND ADJUSTED OPERATING INCOME

(Unaudited)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	OCTOBER 29, 2022	OCTOBER 30, 2021	OCTOBER 29, 2022	OCTOBER 30, 2021
	<i>(dollars in thousands)</i>			
Net income	\$ 98,760	\$ 184,099	\$ 421,746	\$ 541,501
Income tax expense (benefit)	36,162	54,391	(70,867)	99,124
Interest expense—net	31,417	13,223	78,536	40,112
Loss on extinguishment of debt	—	18,513	169,578	21,784
Share of equity method investments losses	1,922	2,313	6,118	6,894
Other expense—net	1,989	—	4,841	—
Operating income	170,250	272,539	609,952	709,415
Asset impairments ⁽¹⁾	10,926	—	19,080	7,354
Non-cash compensation ⁽¹⁾	4,136	5,831	14,315	17,559
Employer payroll taxes on option exercise ⁽¹⁾	—	—	11,717	—
Professional fees ⁽¹⁾	—	—	7,469	—
Compensation settlement ⁽¹⁾	—	—	3,483	—
Recall accrual ⁽¹⁾	—	340	560	840
Legal settlements ⁽¹⁾	(4,188)	—	(4,188)	—
Gain on sale of building and land ⁽¹⁾	(775)	—	(775)	—
Reorganizational related costs ⁽¹⁾	—	—	—	449
Adjusted operating income ⁽²⁾	\$ 180,349	\$ 278,710	\$ 661,613	\$ 735,617
Net revenues	\$ 869,066	\$ 1,006,428	\$ 2,817,978	\$ 2,856,079
Operating margin ⁽³⁾	19.6 %	27.1 %	21.6 %	24.8 %
Adjusted operating margin ⁽³⁾	20.8 %	27.7 %	23.5 %	25.8 %

- (1) Refer to table titled “Reconciliation of GAAP Net Income to Adjusted Net Income” and the related footnotes for additional information.
- (2) Adjusted operating income is a supplemental measure of financial performance that is not required by, or presented in accordance with, GAAP. We define adjusted operating income as consolidated operating income, adjusted for the impact of certain non-recurring and other items that we do not consider representative of our underlying operating performance. Adjusted operating income is included in this shareholder letter because our senior leadership team believes that adjusted operating income provides meaningful supplemental information for investors regarding the performance of our business and facilitates a meaningful evaluation of operating results on a comparable basis with historical results. Our senior leadership team uses this non-GAAP financial measure in order to have comparable financial results to analyze changes in our underlying business from quarter to quarter.
- (3) Operating margin is defined as operating income divided by net revenues. Adjusted operating margin is defined as adjusted operating income divided by net revenues. We are not able to provide a reconciliation of our adjusted operating margin financial guidance or other non-GAAP financial guidance to the corresponding GAAP measure without unreasonable effort because of the uncertainty and variability of the nature and amount of the non-recurring and other items that are excluded from such non-GAAP financial measures. Such adjustments in future periods are generally expected to be similar to the kinds of charges excluded from such non-GAAP financial measure in prior periods. The exclusion of these charges and costs in future periods could have a significant impact on our non-GAAP financial measures.

RECONCILIATION OF NET INCOME TO EBITDA AND ADJUSTED EBITDA
(Unaudited)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	OCTOBER 29, 2022	OCTOBER 30, 2021	OCTOBER 29, 2022	OCTOBER 30, 2021
	<i>(in thousands)</i>			
Net income	\$ 98,760	\$ 184,099	\$ 421,746	\$ 541,501
Depreciation and amortization	28,032	24,819	79,760	71,375
Interest expense—net	31,417	13,223	78,536	40,112
Income tax expense (benefit)	36,162	54,391	(70,867)	99,124
EBITDA ⁽¹⁾	194,371	276,532	509,175	752,112
Loss on extinguishment of debt ⁽²⁾	—	18,513	169,578	21,784
Non-cash compensation ⁽³⁾	10,187	11,995	33,725	37,426
Asset impairments ⁽²⁾	10,926	—	19,080	7,354
Employer payroll taxes on option exercise ⁽²⁾	—	—	11,717	—
Professional fees ⁽²⁾	—	—	7,469	—
Share of equity method investments losses ⁽²⁾	1,922	2,313	6,118	6,894
Other expense—net ⁽⁴⁾	1,989	—	4,841	—
Capitalized cloud computing amortization ⁽⁵⁾	1,747	970	4,800	2,432
Compensation settlements ⁽²⁾	—	—	3,483	—
Recall accrual ⁽²⁾	—	340	560	840
Legal settlement ⁽²⁾	(4,188)	—	(4,188)	—
Gain on sale of building and land ⁽²⁾	(775)	—	(775)	—
Reorganizational related costs ⁽²⁾	—	—	—	449
Adjusted EBITDA ⁽¹⁾	\$ 216,179	\$ 310,663	\$ 765,583	\$ 829,291
Net revenues	\$ 869,066	\$ 1,006,428	\$ 2,817,978	\$ 2,856,079
EBITDA margin ⁽⁶⁾	22.4 %	27.5 %	18.1 %	26.3 %
Adjusted EBITDA margin ⁽⁶⁾	24.9 %	30.9 %	27.2 %	29.0 %

- (1) EBITDA and Adjusted EBITDA are supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. We define EBITDA as consolidated net income before depreciation and amortization, interest expense—net and income tax expense (benefit). Adjusted EBITDA reflects further adjustments to EBITDA to eliminate the impact of non-cash compensation, as well as certain non-recurring and other items that we do not consider representative of our underlying operating performance. EBITDA and Adjusted EBITDA are included in this shareholder letter because our senior leadership team believes that these metrics provide meaningful supplemental information for investors regarding the performance of our business and facilitate a meaningful evaluation of operating results on a comparable basis with historical results. Our senior leadership team uses these non-GAAP financial measures in order to have comparable financial results to analyze changes in our underlying business from quarter to quarter. Our measures of EBITDA and Adjusted EBITDA are not necessarily comparable to other similarly titled captions for other companies due to different methods of calculation.
- (2) Refer to table titled “Reconciliation of GAAP Net Income to Adjusted Net Income” and the related footnotes for additional information.
- (3) Represents non-cash compensation related to equity awards granted to employees, including the non-cash compensation charge related to a fully vested option grant made to Mr. Friedman in October 2020.

- (4) The adjustments for the three and nine months ended October 29, 2022 include losses of \$2.0 million and \$6.6 million, respectively, due to unfavorable exchange rate changes affecting foreign currency denominated transactions, primarily between the U.S. dollar as compared to Pound Sterling and Euro, as well as foreign exchange losses from the remeasurement of an intercompany loan with a U.K. subsidiary. Additionally, the adjustment for the nine months ended October 29, 2022 includes a net gain on derivative instruments of \$1.7 million, respectively, resulting from the completion of certain transactions related to the 2023 Notes and 2024 Notes, including bond hedge and warrant terminations and convertible senior notes repurchases.
- (5) Represents amortization associated with capitalized cloud computing costs.
- (6) EBITDA margin is defined as EBITDA divided by net revenues. Adjusted EBITDA margin is defined as adjusted EBITDA divided by net revenues.

RECONCILIATION OF TRAILING TWELVE MONTHS NET INCOME
TO TRAILING TWELVE MONTHS EBITDA AND
TRAILING TWELVE MONTHS ADJUSTED EBITDA

(Unaudited)

	TRAILING TWELVE MONTHS	
	OCTOBER 29, 2022	
	<i>(in thousands)</i>	
Net income	\$	568,791
Depreciation and amortization		104,407
Interest expense—net		103,371
Income tax benefit—net		(36,433)
EBITDA ⁽¹⁾		740,136
Loss on extinguishment of debt ⁽²⁾		176,932
Non-cash compensation ⁽³⁾		44,777
Asset impairments ⁽⁴⁾		21,356
Employer payroll taxes on option exercise ⁽⁵⁾		11,717
Other expense—net ⁽⁶⁾		7,619
Professional fees ⁽⁷⁾		7,469
Share of equity method investments losses ⁽⁸⁾		7,438
Capitalized cloud computing amortization ⁽⁹⁾		5,933
Compensation settlements ⁽¹⁰⁾		3,483
Recall accrual ⁽¹¹⁾		1,660
Legal settlements ⁽¹²⁾		(4,188)
Gain on sale of building and land ⁽¹³⁾		(775)
Adjusted EBITDA ⁽¹⁾	\$	1,023,557

(1) Refer to footnote (1) within table titled “Reconciliation of Net Income to EBITDA and Adjusted EBITDA.”

(2) Represents a loss on extinguishment of debt related to convertible senior note transactions in the first and second quarters of fiscal 2022, as well as losses related to a portion of the 2023 Notes and 2024 Notes that were early converted at the option of the noteholders.

(3) Represents non-cash compensation related to equity awards granted to employees, including the non-cash compensation charge related to a fully vested option grant made to Mr. Friedman in October 2020.

(4) Represents asset impairment related to inventory, asset impairment related to property and equipment of Galleries under construction and lease impairment due to the early exit of a leased facility.

(5) Represents employer payroll tax expense related to the option exercise by Mr. Friedman in the first quarter of fiscal 2022.

(6) Includes exchange rate changes affecting foreign currency denominated transactions, as well as to foreign exchange losses from the remeasurement of an intercompany loan with a U.K. subsidiary. Additionally, includes net gains on derivative instruments resulting from the completion of certain transactions related to the 2023 Notes and 2024 Notes, including bond hedge and warrant terminations and convertible senior notes repurchases.

(7) Represents professional fees contingent upon the completion of certain transactions related to the 2023 Notes and 2024 Notes, including bond hedge and warrant terminations and convertible senior notes repurchases.

(8) Represents our proportionate share of the losses of our equity method investments.

(9) Represents amortization associated with capitalized cloud computing costs.

(10) Represents compensation settlements related to the Rollover Units and Profit Interest Units in the Waterworks subsidiary.

- (11) Represents accruals associated with product recalls.
- (12) Represents a legal settlement associated with a lease arrangement.
- (13) Represents gain on sale of building and land.

CALCULATION OF TOTAL DEBT, TOTAL NET DEBT
AND RATIO OF TOTAL NET DEBT TO
TRAILING TWELVE MONTHS ADJUSTED EBITDA
(Unaudited)

	OCTOBER 29, 2022	INTEREST RATE ⁽¹⁾
	<i>(dollars in thousands)</i>	
Asset based credit facility	\$ —	4.88%
Term loan B ⁽²⁾	1,980,000	5.62%
Term loan B-2 ⁽²⁾	500,000	6.38%
Equipment promissory note ⁽²⁾	1,691	4.56%
Convertible senior notes due 2023 ⁽²⁾	1,707	0.00%
Convertible senior notes due 2024 ⁽²⁾	41,904	0.00%
Notes payable for share repurchases	315	4.14%
Total debt	\$ 2,525,617	
Cash and cash equivalents	(2,150,466)	
Total net debt ⁽³⁾	\$ 375,151	
Trailing twelve months adjusted EBITDA ⁽⁴⁾	\$ 1,023,557	
Ratio of total net debt to trailing twelve months adjusted EBITDA ⁽⁴⁾		0.4

(1) The interest rates for the asset based credit facility, term loans, equipment promissory note and notes payable for share repurchases represent the weighted-average interest rates as of October 29, 2022.

(2) Amounts exclude discounts upon original issuance and third party offering and debt issuance costs.

(3) Net debt excludes restricted cash of \$3.9 million and non-recourse real estate loans of \$18 million as of October 29, 2022 related to our consolidated variable interest entities from our joint venture activities. These real estate loans are secured by the assets of such entities and the associated creditors do not have recourse against RH's general assets.

(4) The ratio of total net debt to trailing twelve months adjusted EBITDA is calculated by dividing total net debt by trailing twelve months adjusted EBITDA. Refer to table titled "Reconciliation of Trailing Twelve Months Net Income to Trailing Twelve Months EBITDA and Trailing Twelve Months Adjusted EBITDA" and the related footnotes for definitions of EBITDA and adjusted EBITDA.