



A LETTER FROM OUR CHAIRMAN AND CEO

## TO OUR PEOPLE, PARTNERS, AND SHAREHOLDERS,

Fiscal 2019 was an outstanding year for Team RH. We achieved record results across every key metric of our business while continuing to elevate the brand and create strategic separation in our industry. Revenues increased 5.4% over last year to \$2.647 billion, adjusted operating margins reached an industry best 14.3%, and adjusted diluted earnings per share increased 49% to \$11.66. We also generated \$330 million of free cash flow in 2019, and achieved industry leading ROIC of 35.3%.

While proud of the outstanding results our team achieved last year, clearly much has changed as a result of the rapid spread of COVID-19 around the world. Our hearts go out to all of those whose lives are being impacted by the virus, and we are eternally grateful for all the brave souls who are on the front lines putting their health at risk to protect ours.

Like others, we have taken the expected steps of deferring new business introductions and capital spending, while reducing costs to navigate through the short-term challenges of this crisis. Unlike others, and due to our exceptional financial model, we believe we are well positioned to take advantage of the many opportunities that present themselves during times of dislocation. At RH, we live by Einstein's three rules of work. "Out of clutter find simplicity. From discord find harmony. In the middle of difficulty lies opportunity."

It was during the depths of the Great Recession, when the word "value", drove an entire industry to lower quality and reduce prices, that we chose to move in the opposite direction, raising the quality of our offering, positioning RH as a disruptive force in the lucrative luxury home furnishings market. Out of the clutter of the current crisis, and in the middle of what seems like the most difficult of times, we are once again focused on elevating and reimagining the RH brand in a manner that will, in the words of Steve Jobs, "Change everything, again."

## THERE ARE THOSE WITH TASTE AND NO SCALE, AND THOSE WITH SCALE AND NO TASTE

RH at its core is about taste, and we believe the idea of scaling taste is large and far reaching.

The RH brand attracts the best designers, artisans, and manufacturers in our industry, scaling and rendering their work more valuable across our integrated platform, enabling us to curate the most compelling collection of luxury home furnishings in the world. Our strategy to open new design galleries in every major market will unlock the value of our vast assortment, generating revenues of \$5 to \$6 billion in North America, with the long term potential to become a \$20 billion dollar global brand.

Our vision 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 elevate and establish the RH brand as a global thought leader, taste, and placemaker.

As an example, our product is elevated and rendered more valuable by our architecturally inspiring Galleries, which are further elevated and rendered more valuable by our seamlessly integrated hospitality experience. Our Hospitality efforts will continue to elevate the RH brand as we move 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 hotel industry. Additionally, we are creating bespoke hospitality experiences like RH Yountville, an integration of Food, Wine, Art & Design in the Napa Valley, 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 existing and new customers to our evolving authority in interior design, architecture, landscape architecture and hospitality.

This leads to our strategy of building the world's first consumer facing Interior Design, Architecture, and Landscape Architecture services platform inside our Galleries, again elevating the RH brand and amplifying our core business by adding new revenue streams while disrupting and redefining multiple industries.

Our ecosystem will come full circle as we begin to conceptualize and sell spaces, moving the brand beyond the \$200 billion home furnishings market into the \$1.7 trillion North American housing market by offering beautifully designed and furnished turnkey homes and condominiums with the introduction of RH Residences.

The entire ecosystem will come to life digitally as we transform our website into The World of RH, a portal presenting our Products, Places, Services, and Spaces.

We believe the ecosystem can be expanded globally, multiplying the market opportunity to approximately \$7 to \$10 trillion, quite possibly one of the largest and most lucrative addressed by any brand in the world today. A one percent share of the global market represents a \$70 to \$100 billion opportunity.

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.

## LUXURY GOODS ARE THE ONLY AREA IT IS POSSIBLE TO MAKE LUXURY MARGINS ~ Bernard Arnault

We have spent decades building a business model that generates industry leading profitability and return on invested capital, and believe, like Bernard Arnault, "Luxury goods are the only area it is possible to make luxury margins."

The emergence of RH as a luxury brand generating luxury margins is becoming evident as our adjusted operating margin has expanded over 700 basis points in the past two years from 7.0% in 2017 to 14.3% in 2019. We continue to expect operating margins to expand in 2020 despite the current setbacks from COVID-19, and now see a clear path to 20% operating margin over the next few years.

We also believe this recent period has been reminiscent of previous times when growth without profitability has been unjustly rewarded, and valuations were based on the misplaced belief that an online retail business is more profitable than a physical store. This view has driven new concepts to launch as "digitally native brands" chasing internet valuations and cheap capital from private and public markets that have somehow confused an online retail startup with a technology company. It's becoming clear that retail brands birthed online desperately need a store lifeline to survive, as many are finding the variable cost of marketing an invisible store leads to an unprofitable path to the future.

Traditional retailers hoping for the same favorable valuations, and in some cases driven by the fear of not being viewed as fashionable by millennials, have allocated the vast majority of their capital to unnaturally grow their digital business. This has resulted in shifting, not lifting, sales online at greater costs, driving down margins while physical stores have been left to rot.

We, on the other hand, have built an integrated multi-channel platform that expresses our brand seamlessly across physical, digital and print. Our physical Galleries are architecturally inspiring spaces that blur the lines between residential and retail, indoors and outdoors, home and hospitality, with seamlessly integrated restaurants and brand amplifying services like RH Interior Design, all of which render our brand more valuable while creating a customer experience that cannot be replicated online.

Our digital experience, inclusive of RH Interiors, Modern, Outdoor, Baby & Child plus Teen generates over a billion dollars online, while our Source Books inspire millions of customers driving traffic to our Galleries and websites.

We believe the combination of our luxury positioning, the inspiring presentation of our collections across all channels, and the fact that we control our brand from concept to customer, will enable RH to continue to disrupt the highly fragmented luxury home furnishings market, expand our operating margins, and take share for years to come.

## CLIMBING THE LUXURY MOUNTAIN WHILE BUILDING A BRAND WITH NO PEER

Hermès, Chanel, Louis Vuitton, Gucci, Cartier, Tiffany, and the rest of the finest luxury brands in the world were all born on the top of the luxury mountain. Never has a brand started near the base and made the climb to the peak. We believe RH can be the first to make the climb, knowing very well those at the top don't necessarily want us to. To make the climb, we understand that our work has to be so extraordinary that it creates a forced reconsideration of our brand, requiring them to tip their hat, if you will.

It is not a climb for the faint of heart, requiring imagination, innovation, and a great deal of persistence and perspiration. We have to be willing to endure short-term pain to drive long-term gain, as we did moving from a promotional to a membership model, redesigning our operating platform, eliminating our holiday assortments, or managing the business with a bias for earnings versus revenues as we built a durable platform to support long-term high-quality growth.

We also understand the strategies we are pursuing – opening the largest specialty retail experiences in our industry, while most are shrinking the size of their retail footprint or closing stores; moving from a promotional to a membership model, while others are increasing promotions, positioning their brands around price versus product; continuing to mail inspiring Source Books, while many are eliminating catalogs; and refusing to follow the herd in self-promotion on social media, instead allowing our brand to be defined by the taste, design, and quality of the products and experiences we are creating – are all in direct conflict with conventional wisdom and the plans being pursued by many in our industry.

We believe when you step back and consider: one, we are building a brand with no peer; two, we are creating a customer experience that cannot be replicated online; and three, we have total control of our brand from concept to customer, you realize what we are building is extremely rare in today's retail landscape and we would argue, will also prove to be equally valuable.

## THIS IS A TIME TO BE DEFINED BY OUR VISION, NOT BY A VIRUS

As we move forward past the dark days of the pandemic, let this be a pivot point where we once again rise up. It is not a time to shelter and shrink, it is a time to expand and shine. It is not a time to revert back to old ways and former days, it is a time to reimagine new ways and brighter days. It is not a time to do less, it is a time to do more with less. It is not a time to be victims of our current reality, it is a time to be visionaries, destroying today's reality to create tomorrow's future.

Let this be a time we look back upon and remember our resurrection. A time we reimagined and reinvented ourselves once again. A time Team RH unleashed the greatest display of innovation our industry has ever seen.

A time we once again become, unimaginable.

This is a time to be defined by our vision, not by a virus.

Carpe Diem,

A handwritten signature in black ink, appearing to read "Gary", written in a cursive, stylized font.

Gary Friedman  
Chairman & Chief Executive Officer