

Carlyle Group L.P.
Form 10-Q
November 12, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2013

OR

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

FOR THE TRANSITION PERIOD FROM TO

Commission File Number: 001-35538

The Carlyle Group L.P.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

45-2832612
(I.R.S. Employer

Identification No.)

1001 Pennsylvania Avenue, NW

Washington, D.C., 20004-2505

(Address of principal executive offices)(Zip Code)

(202) 729-5626

(Registrant's telephone number, including area code)

Not Applicable

(Former name or former address, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of the Registrant's common units representing limited partner interests outstanding as of November 8, 2013 was 49,286,225.

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Forward-Looking Statements

This report may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which reflect our current views with respect to, among other things, our operations and financial performance. You can identify these forward-looking statements by the use of words such as outlook, believe, expect, potential, continue, may, will, seek, approximately, predict, intend, plan, estimate, anticipate or the negative version of these words or other comparable words. Such forward-looking statements are subject to various risks and uncertainties. Accordingly, there are or will be important factors that could cause actual outcomes or results to differ materially from those indicated in these statements. We believe these factors include but are not limited to those described under Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2012, as such factors may be updated from time to time in our periodic filings with the United States Securities and Exchange Commission (the SEC), which are accessible on the SEC's website at www.sec.gov. These factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this report and in our other periodic filings. We undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise, except as required by law.

Website and Social Media Disclosure

We use our website (www.carlyle.com), our corporate Facebook page (<http://www.facebook.com/pages/The-Carlyle-Group/103519702981?rf=110614118958798>) and our corporate Twitter account (@OneCarlyle) as channels of distribution of company information. The information we post through these channels may be deemed material. Accordingly, investors should monitor these channels, in addition to following our press releases, SEC filings and public conference calls and webcasts. In addition, you may automatically receive email alerts and other information about Carlyle when you enroll your email address by visiting the Email Alert Subscription section at <http://ir.carlyle.com/alerts.cfm>. The contents of our website and social media channels are not, however, a part of this report.

Prior to the reorganization in May 2012 in connection with our initial public offering, our business was owned by four holding entities: TC Group, L.L.C., TC Group Cayman, L.P., TC Group Investment Holdings, L.P. and TC Group Cayman Investment Holdings, L.P. We refer to these four holding entities collectively as the Parent Entities. The Parent Entities were under the common ownership and control of our senior Carlyle professionals and two strategic investors that owned minority interests in our business entities affiliated with Mubadala Development Company, an Abu-Dhabi based strategic development and investment company (Mubadala), and California Public Employees Retirement System (CalPERS). Unless the context suggests otherwise, references in this report to Carlyle, the Company, we, us and our refer (1) prior to consummation of our reorganization into a holding partnership structure to Carlyle Group, which was comprised of the Parent Entities and their consolidated subsidiaries and (2) after our reorganization into a holding partnership structure, to The Carlyle Group L.P. and its consolidated subsidiaries. In addition, certain individuals engaged in our businesses own interests in the general partners of our existing carry funds. Certain of these individuals contributed a portion of these interests to us as part of the reorganization. We refer to these individuals, together with the owners of the Parent Entities prior to the reorganization and our initial public offering, collectively as our pre-IPO owners.

When we refer to the partners of The Carlyle Group L.P., we are referring specifically to the common unitholders and our general partner and any others who may from time to time be partners of that specific Delaware limited partnership. When we refer to our senior Carlyle professionals, we are referring to the partner-level personnel of our firm. Senior Carlyle professionals, together with CalPERS and Mubadala, were the owners of our Parent Entities prior to the reorganization. References in this report to the ownership of the senior Carlyle professionals include the ownership of personal planning vehicles of these individuals.

Carlyle funds, our funds and our investment funds refer to the investment funds and vehicles advised by Carlyle. Our carry funds refer to those investment funds that we advise, including the buyout funds, growth capital funds, real estate funds, infrastructure funds, certain energy funds and distressed debt and mezzanine funds (but excluding our structured credit funds, hedge funds, fund of funds vehicles and the NGP management fee funds), where we receive a special residual allocation of income, which we refer to as a carried interest, in the event that specified investment returns are achieved by the fund. The NGP management fee funds refer to those funds advised by NGP Energy Capital Management (together with its affiliates and subsidiaries, NGP). Our fund of funds vehicles refers to those funds, accounts and vehicles advised by AlpInvest Partners B.V., formerly known as AlpInvest Partners N.V. (AlpInvest).

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Fee-earning assets under management or Fee-earning AUM refer to the assets we manage from which we derive recurring fund management fees. Our Fee-earning AUM generally equals the sum of:

- (a) for carry funds and certain co-investment vehicles where the original investment period has not expired, the amount of limited partner capital commitments, for fund of funds vehicles, the amount of external investor capital commitments during the commitment fee period, and for the NGP management fee funds, the amount of investor capital commitments before the first investment realization;
- (b) for substantially all carry funds and certain co-investment vehicles where the original investment period has expired, the remaining amount of limited partner invested capital, and for the NGP management fee funds where the first investment has been realized, the amount of partner commitments less realized and written-off investments;
- (c) the amount of aggregate Fee-earning collateral balance at par of our collateralized loan obligations (CLOs), as defined in the fund indentures (typically exclusive of equities and defaulted positions) as of the quarterly cut-off date for each CLO, and the reference portfolio notional amount of our synthetic collateralized loan obligations (synthetic CLOs);
- (d) the external investor portion of the net asset value (pre-redemptions and subscriptions) of our long/short credit, emerging markets, multi-product macroeconomic and other hedge funds;
- (e) the gross assets (including assets acquired with leverage), excluding cash and cash equivalents of our business development companies; and
- (f) for fund of funds vehicles where the commitment fee period has expired, and certain carry funds where the investment period has expired, the lower of cost or fair value of invested capital.

Assets under management or AUM refers to the assets we manage. Our AUM equals the sum of the following:

- (a) the fair value of the capital invested in our carry funds, co-investment vehicles, fund of funds vehicles and the NGP management fee funds plus the capital that we are entitled to call from investors in those funds and vehicles (including our commitments to those funds and vehicles and those of senior Carlyle professionals and employees) pursuant to the terms of their capital commitments to those funds and vehicles;
- (b) the amount of aggregate collateral balance and principal cash at par of our CLOs (inclusive of all positions) and the reference portfolio notional amount of our synthetic CLOs;
- (c) the net asset value (pre-redemptions and subscriptions) of our long/short credit, emerging markets, multi-product macroeconomic and other hedge funds; and
- (d) the gross assets (including assets acquired with leverage) of our business development companies.

We include in our calculation of AUM and Fee-earning AUM certain energy and renewable resources funds that we jointly advise with Riverstone Holdings LLC (Riverstone) and certain NGP management fee funds.

For our carry funds, co-investment vehicles, fund of funds vehicles and the NGP management fee funds, total AUM includes the fair value of the capital invested, whereas Fee-earning AUM includes the amount of capital commitments or the remaining amount of invested capital, depending on whether the investment period for the fund has expired. As such, Fee-earning AUM may be greater than total AUM when the aggregate fair value of the remaining investments is less than the cost of those investments.

Our calculations of AUM and Fee-earning AUM may differ from the calculations of other alternative asset managers. As a result, these measures may not be comparable to similar measures presented by other alternative asset managers. In addition, our calculation of AUM (but not Fee-earning AUM) includes uncalled commitments to, and the fair value of invested capital in, our investment funds from Carlyle and our personnel, regardless of whether such commitments or invested capital are subject to management or performance fees. Our calculations of AUM or Fee-earning AUM are not based on any definition of AUM or Fee-earning AUM that is set forth in the agreements governing the investment funds that we manage.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****The Carlyle Group L.P.****Condensed Consolidated Balance Sheets****(Dollars in millions)**

	September 30, 2013 (Unaudited)	December 31, 2012
Assets		
Cash and cash equivalents	\$ 855.7	\$ 567.1
Cash and cash equivalents held at Consolidated Funds	1,494.9	1,646.6
Restricted cash	79.6	34.5
Restricted cash and securities of Consolidated Funds	25.7	36.3
Accrued performance fees	2,877.7	2,192.5
Investments	794.0	881.2
Investments of Consolidated Funds	26,118.0	24,815.7
Due from affiliates and other receivables, net	176.1	190.7
Due from affiliates and other receivables of Consolidated Funds, net	493.6	331.8
Receivables and inventory of a consolidated real estate VIE	191.4	
Fixed assets, net	63.3	63.6
Deposits and other	43.3	48.4
Other assets of a consolidated real estate VIE	42.7	
Intangible assets, net	580.3	691.1
Deferred tax assets	69.0	67.1
Total assets	\$ 33,905.3	\$ 31,566.6
Liabilities and partners' capital		
Loans payable	\$ 25.0	\$ 886.3
3.875% senior notes due 2023	499.8	
5.625% senior notes due 2043	398.4	
Loans payable of Consolidated Funds	15,070.6	13,656.7
Loans payable of a consolidated real estate VIE at fair value (principal amount of \$335.1)	123.8	
Accounts payable, accrued expenses and other liabilities	236.5	215.0
Accrued compensation and benefits	1,797.8	1,318.2
Due to affiliates	403.2	332.1
Deferred revenue	196.9	59.4
Deferred tax liabilities	92.6	61.1
Other liabilities of Consolidated Funds	1,144.6	1,385.8
Other liabilities of a consolidated real estate VIE	110.3	
Accrued giveback obligations	48.7	69.2
Total liabilities	20,148.2	17,983.8
Commitments and contingencies		
Redeemable non-controlling interests in consolidated entities	4,199.1	2,887.4
Partners' capital (common units, 49,209,545 and 43,244,180 issued and outstanding as of September 30, 2013 and December 31, 2012, respectively)	278.3	235.1
Accumulated other comprehensive loss	(11.5)	(4.8)

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Partners' capital appropriated for Consolidated Funds	451.4	838.6
Non-controlling interests in consolidated entities	7,380.1	8,264.8
Non-controlling interests in Carlyle Holdings	1,459.7	1,361.7
Total partners' capital	9,558.0	10,695.4
Total liabilities and partners' capital	\$ 33,905.3	\$ 31,566.6

See accompanying notes.

Table of Contents**The Carlyle Group L.P.****Condensed Consolidated Statements of Operations****(Unaudited)****(Dollars in millions, except unit and per unit data)**

	Three Months Ended		Nine Months Ended	
	September 30, 2013	2012	2013	September 30, 2012
Revenues				
Fund management fees	\$ 257.9	\$ 239.8	\$ 731.5	\$ 714.1
Performance fees				
Realized	108.6	291.4	564.6	688.7
Unrealized	211.9	64.9	657.4	88.0
Total performance fees	320.5	356.3	1,222.0	776.7
Investment income				
Realized	(3.1)	9.8	5.4	11.4
Unrealized	8.1	0.4	11.0	27.3
Total investment income	5.0	10.2	16.4	38.7
Interest and other income	2.7	4.5	9.2	9.9
Interest and other income of Consolidated Funds	302.0	247.7	823.3	678.4
Total revenues	888.1	858.5	2,802.4	2,217.8
Expenses				
Compensation and benefits				
Base compensation	204.2	177.0	556.3	433.0
Equity-based compensation	78.7	53.2	257.0	147.4
Performance fee related				
Realized	45.4	121.9	232.2	188.3
Unrealized	113.5	41.5	374.5	(1.4)
Total compensation and benefits	441.8	393.6	1,420.0	767.3
General, administrative and other expenses	136.4	92.9	368.1	268.1
Interest	11.7	4.0	33.8	20.6
Interest and other expenses of Consolidated Funds	217.2	204.1	669.0	568.1
Other non-operating expense	7.6	10.3	1.9	6.9
Total expenses				Loss before income taxes
	814.7	704.9	2,492.8	(3,708)
Income tax expense	56	56		(3,672)
Net loss	\$ (3,764)	\$ (3,728)		
Shares used in computing basic and diluted net loss per share	1,000	1,000		
Basic and diluted net loss per share	\$ (3,764)	\$ (3,728)		

NOTE 3 RECENT ACCOUNTING PRONOUNCEMENTS

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

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

	May 4, 2013	February 2, 2013
Prepaid catalog	\$ 83,202	\$ 43,828
Vendor deposits	22,256	20,383
Prepaid expense	14,139	11,479
Other current assets	1,738	1,339
Total prepaid expense and other current assets	\$ 121,335	\$ 77,029

NOTE 5 GOODWILL AND INTANGIBLE ASSETS

The following sets forth the goodwill and intangible assets as of May 4, 2013 (*dollar amounts in thousands*):

	Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net Book Value	Useful Life
Intangible assets subject to amortization:					
Core technologies	\$ 6,580	\$ (6,470)	\$	\$ 110	5 years
Fair value of leases					
Fair market write-up	10,443	(8,466)	47	2,024	(2)
Fair market write-down	(2,591)	1,861		(730) ⁽¹⁾	(2)
Total intangible assets subject to amortization	14,432	(13,075)	47	1,404	
Intangible assets not subject to amortization:					
Goodwill	122,285		296	122,581	
Trademarks and domain names	47,410			47,410	
Total intangible assets	\$ 184,127	\$ (13,075)	\$ 343	\$ 171,395	

(1) The fair market write-down of leases is included in other long-term obligations on the condensed consolidated balance sheets.

(2) The fair value of each lease is amortized over the life of the respective lease. The longest lease for which a fair value adjustment was recorded has a termination date in January 2019.

The following sets forth the goodwill and intangible assets as of February 2, 2013 (*dollar amounts in thousands*):

	Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net Book Value	Useful Life
Intangible assets subject to amortization:					
Core technologies	\$ 6,580	\$ (6,141)	\$	\$ 439	5 years
Fair value of leases					
Fair market write-up	10,737	(8,511)	48	2,274	(2)

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Fair market write-down	(2,591)	1,789	(802) ⁽¹⁾	(2)
Total intangible assets subject to amortization	14,726	(12,863)	48	1,911
Intangible assets not subject to amortization:				
Goodwill	122,285		316	122,601
Trademarks and domain names	47,410			47,410
Total intangible assets	\$ 184,421	\$ (12,863)	\$ 364	\$ 171,922

- (1) The fair market write-down of leases is included in other long-term obligations on the condensed consolidated balance sheets.
- (2) The fair value of each lease is amortized over the life of the respective lease. The longest lease for which a fair value adjustment was recorded has a termination date in January 2019.

Table of Contents**NOTE 6 ACCOUNTS PAYABLE AND ACCRUED EXPENSES**

Accounts payable and accrued expenses consist of the following (*in thousands*):

	May 4, 2013	February 2, 2013
Accounts payable	\$ 74,712	\$ 81,608
Accrued catalog costs	42,548	6,906
Accrued compensation	22,386	16,621
Accrued freight and duty	15,866	17,639
Accrued sales taxes	10,727	12,783
Accrued occupancy	5,869	5,842
Accrued professional fees	3,897	2,114
Other accrued expenses	3,415	1,840
Total accounts payable and accrued expenses	\$ 179,420	\$ 145,353

Accounts payable included negative cash balances due to outstanding checks of \$9.8 million and \$28.1 million as of May 4, 2013 and February 2, 2013, respectively.

NOTE 7 LINE OF CREDIT

As of May 4, 2013, \$114.0 million was outstanding under the revolving line of credit and the undrawn borrowing availability under the revolving line of credit was \$138.5 million. There were \$20.2 million and \$19.5 million in outstanding letters of credit as of May 4, 2013 and February 2, 2013, respectively.

Borrowings under the revolving line of credit are subject to interest, at the borrowers' option, at either the bank's reference rate or LIBOR (or the BA Rate or the Canadian Prime Rate, as such terms are defined in the credit agreement, for Canadian borrowings denominated in Canadian dollars or the United States Index Rate or LIBOR for Canadian borrowings denominated in United States dollars) plus an applicable margin rate, in each case. The weighted-average interest rate for the revolving line of credit was 2.74% as of May 4, 2013.

The credit agreement contains various restrictive covenants, including, among others, limitations on the ability to incur liens, make loans or other investments, incur additional debt, issue additional equity, merge or consolidate with or into another person, sell assets, pay dividends or make other distributions, or enter into transactions with affiliates, along with other restrictions and limitations typical to credit agreements of this type and size. As of May 4, 2013, the Company was in compliance with all covenants contained in the credit agreement.

NOTE 8 INCOME TAXES

The effective tax rate was 51.06% and (1.51)% for the three months ended May 4, 2013, and April 28, 2012, respectively. The increase in the effective tax rate for the three months ended May 4, 2013 was primarily due to no longer recording a U.S. valuation allowance against net deferred tax assets, as well as non-deductible stock-based compensation charges.

As of the end of fiscal year 2012, the Company's U.S. operations achieved a position of cumulative profits (adjusted for permanent differences) for the most recent three-year period. The Company concluded that this record of cumulative profitability in recent years, coupled with its business plan for profitability in future periods, provided assurance that its future tax benefits more likely than not would be realized. Accordingly, in the fourth quarter of fiscal 2012, the Company released all of its U.S. valuation allowance of \$57.2 million against net deferred tax assets.

As of May 4, 2013, the Company has retained a valuation allowance of \$0.3 million against deferred tax assets for its Shanghai operations.

As of both May 4, 2013 and February 2, 2013, \$1.8 million of the exposures related to unrecognized tax benefits would affect the effective tax rate if realized and are included in other long-term obligations on the condensed consolidated balance sheets. These amounts are primarily associated with foreign tax exposures that would, if realized, reduce the amount of net operating losses that would ultimately be utilized. As of

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May 4, 2013, \$0.3 million of the exposures related to unrecognized tax benefits are expected to decrease in the next 12 months due to the lapse of the statute of limitations.

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Adjustments required upon adoption of accounting for uncertainty in income taxes related to deferred tax asset accounts were offset by the related valuation allowance. Future changes to the Company's assessment of the realizability of those deferred tax assets will impact the effective tax rate. The Company accounts for interest and penalties related to exposures as a component of income tax expense. The Company has accrued \$0.5 million of interest expense associated with exposures as of May 4, 2013 and February 2, 2013.

NOTE 9 EARNINGS PER SHARE

For the three months ended May 4, 2013, options and restricted stock units of 8,246,577 and 41,713, respectively, were excluded from the calculation of diluted net loss per share because their inclusion would have been anti-dilutive due to the Company's net loss in the period. The Company did not have any anti-dilutive securities in the three months ended April 28, 2012 because all securities granted in that period were granted by Home Holdings.

The weighted-average number of shares for the three months ended April 28, 2012 is calculated by giving effect to the capitalization of Restoration Hardware Holdings, Inc. on September 2, 2011.

NOTE 10 STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation in accordance with applicable guidance, which requires the Company to estimate the value of securities issued based upon an option-pricing model and recognize this estimated value as compensation expense over the vesting periods.

Team Resto Ownership Plan

Home Holdings established the Team Resto Ownership Plan in fiscal 2009. Awards under the Team Resto Ownership Plan were granted by the Home Holdings and were made up of the following:

Time-based units time-based units vested in annual installments, generally over a five-year graded vesting period.

Performance-based units performance-based units vested based on a return on equity investment to the Company's investors between either two times and three times such investment or three times and five times such investment.

All stock-based compensation expense associated with the grants of units by Home Holdings to the Company's directors, executive officers and employees was recorded by the Company.

On November 7, 2012, the Company completed its initial public offering and at the time of the initial public offering, outstanding units under the Team Resto Ownership Plan were replaced with common stock of the Company.

The Company did not record any stock-based compensation expense for these time-based units in the three months ended May 4, 2013. The Company recorded stock-based compensation expense for time-based units of \$0.4 million in the three months ended April 28, 2012, which is included in selling, general and administrative expenses on the condensed consolidated statements of operations. No stock-based compensation cost has been capitalized in the accompanying condensed consolidated financial statements.

The Company recognizes expense associated with performance-based units when it becomes probable that the performance condition will be met. Once it becomes probable that a participant will vest, the Company recognizes compensation expense equal to the number of shares which have vested multiplied by the fair value of the related shares measured at the grant date. No expense was recorded in either the three months ended May 4, 2013 or April 28, 2012 related to these performance-based units.

2012 Equity Replacement Plan

In connection with the Reorganization, the Board of Directors adopted the Restoration Hardware 2012 Equity Replacement Plan (the Replacement Plan), and outstanding units under the Team Resto Ownership Plan were replaced with vested and unvested shares of common stock under the Replacement Plan, in some cases subject to selling restrictions.

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A portion of the shares issued under the Replacement Plan are unvested restricted shares issued to Carlos Alberini, the Company's Chief Executive Officer, and Gary Friedman, who serves as the Company's Creator and Curator, in replacement of certain of their performance-based units granted under the Team Resto Ownership Plan. With respect to the 1,331,548 shares received by Mr. Alberini and Mr. Friedman in replacement of certain of their performance-based units, such shares begin to vest during the 36-month period following the initial public offering when the price of the Company's common stock reaches a 10-day average closing price per share of \$31.00 for at least 10 consecutive trading days, and such shares shall fully vest when the price of the Company's common stock reaches a 10-day average closing price per share of \$46.50 for at least 10 consecutive trading days (with proportional vesting in between). In addition, with respect to the 512,580 shares received by Mr. Alberini and Mr. Friedman in replacement of certain of their performance-based units, such shares begin to vest during the 36-month period following the initial public offering

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when the 10-day average closing price of the Company's common stock exceeds the initial public offering price of \$24.00 per share for at least 10 consecutive trading days, and such shares fully vest when the 10-day average closing price of the Company's common stock reaches a price per share of \$31.00 for at least 10 consecutive trading days (with proportional vesting in between) during the period.

In connection with Mr. Friedman's resignation and new role as the Creator and Curator, 1,185,511 shares of unvested stock he received in replacement of certain performance-based units will be marked to market every period until the required vesting criteria are met in accordance with ASC Topic 718.

During the three months ended May 4, 2013, 140,457 shares of the 1,331,548 shares received by Mr. Alberini and Mr. Friedman in replacement of certain of their performance-based units had vested in accordance with the performance objective as described above. The Company recorded a non-cash compensation charge of \$3.4 million related to these awards in the three months ended May 4, 2013 which is included in selling, general and administrative expenses on the condensed consolidated statements of operations.

In May 2013, the remaining 748,159 shares received by Mr. Alberini and Mr. Friedman in replacement of certain of their performance-based units had vested in accordance with the performance objective described above. The Company will record a non-cash compensation charge of \$26.5 million related to these awards in the second quarter of fiscal 2013. No additional compensation expense will be recorded in future periods related to these awards.

2012 Stock Option Plan and 2012 Stock Incentive Plan

As of May 4, 2013, 8,246,577 options were outstanding with a weighted-average exercise price of \$41.34 per share and 8,093,077 options were vested with a weighted-average exercise price of \$41.48 per share.

The aggregate intrinsic value of options outstanding, options vested or expected to vest, and options exercisable as of May 4, 2013 was \$24.9 million, \$24.9 million, and \$24.1 million, respectively. Stock options exercisable as of May 4, 2013 had a weighted-average remaining contractual life of 9.50 years.

As of May 4, 2013, the total unrecognized compensation expense related to unvested options was \$1.2 million, which is expected to be recognized on a straight-line basis over a weighted-average period of 3.76 years.

As of May 4, 2013, the Company had 41,713 unvested restricted stock unit awards with a weighted-average grant date fair value of \$36.69 per share. No restricted stock unit awards vested during the three months ended May 4, 2013. As of May 4, 2013, there was \$1.1 million of total unrecognized compensation expense related to unvested restricted stock unit awards which is expected to be recognized over a weighted-average period of 3.06 years.

The Company recorded stock-based compensation expense of \$0.2 million in the three months ended May 4, 2013 with respect to grants of stock options and restricted stock unit awards, which is included in selling, general and administrative expenses on the condensed consolidated statements of operations. No stock-based compensation cost has been capitalized in the accompanying condensed consolidated financial statements.

NOTE 11 RELATED PARTY TRANSACTIONS

The Company's former Chairman and Co-Chief Executive Officer, Gary Friedman, resigned from these positions and as a director of the Company effective as of October 20, 2012. In connection with such resignation, Mr. Friedman and the Company entered into an advisory services agreement that provides for Mr. Friedman to advise the Company in his role as the Creator and Curator with respect to product development, merchandising and other creative matters. The agreement has a five-year term and is renewable for an additional five-year period. In addition, in connection with the Company's initial public offering, Home Holdings has agreed to invest \$5 million, consisting of \$2.5 million in an initial tranche and up to \$2.5 million in one or more additional tranches, directly or indirectly, in Hierarchy, LLC (Hierarchy), a newly formed entity in which Mr. Friedman has a controlling interest. If requested by Home Holdings and agreed to by the Company, the Company may make these subsequent investments. The Company will have the right to acquire all or a portion of Home Holdings' interest in Hierarchy between the second and third anniversaries of the Company's initial public offering, at the greater of the then fair market value and the price paid by Home Holdings. As of May 4, 2013, the initial investment tranche of \$2.5 million had not been funded by Home Holdings.

In addition, Home Holdings has assigned to the Company its right of first offer and co-sale right over the sale by Mr. Friedman of his interests in Hierarchy, its right of first offer over the sale of Hierarchy or any of its lines of business and its preemptive rights on issuances of additional interests in Hierarchy. The agreements among Hierarchy, Home Holdings, Mr. Friedman and the Company contemplate that the Company will

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enter into an agreement to provide Hierarchy with back office, logistics, supply chain and administrative support, with pricing determined based on the fair market value of such services. Unless otherwise agreed by Home Holdings, for two years from the date of the Hierarchy operating agreement, Hierarchy's line of business will be limited to apparel and apparel related businesses. In addition, Hierarchy will be permanently prohibited from entering into lines of business in which the

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Company is engaged and certain lines of business in which the Company may become engaged (other than luggage, which Hierarchy may enter into after such two year period). Mr. Friedman is also a significant stockholder in the Company and will continue to advise the Board of Directors in an observer capacity, with the honorary title of Chairman Emeritus.

NOTE 12 COMMITMENTS AND CONTINGENCIES

Commitments

The Company has no off balance sheet commitments as of May 4, 2013.

Contingencies

The Company is involved from time to time in various legal claims, actions and complaints arising in connection with its business. The outcome of matters in which the Company is involved cannot be determined at this time and the results cannot be predicted with certainty and could result in unexpected expenses and liability and could also materially adversely affect the Company's operations.

The Company reviews the need for any loss contingency reserves and establishes reserves when, in the opinion of management, it is probable that a matter would result in liability, and the amount of loss, if any, can be reasonably estimated. Generally, in view of the inherent difficulty of predicting the outcome of those matters, particularly in cases in which claimants seek substantial or indeterminate damages, it is not possible to determine whether a liability has been incurred or to reasonably estimate the ultimate or minimum amount of that liability until the case is close to resolution, in which case no reserve is established until that time.

NOTE 13 SEGMENT REPORTING

The Company defines an operating segment on the same basis that it uses to evaluate performance internally by the Chief Operating Decision Maker (CODM). The Company has determined that the Chief Executive Officer (or Co-Chief Executive Officers prior to Mr. Friedman's resignation from such position) was its CODM and there was one operating segment. Therefore, the Company reports as a single segment. This includes all sales channels accessed by the Company's customers, including sales through catalogs, sales through the Company's website and sales through the Company's stores.

The Company classifies its sales into furniture and non-furniture product lines. Furniture includes both indoor and outdoor furniture from the Company's business lines. Non-furniture includes lighting, textiles, accessories and home décor. Net revenues in each category were as follows (*in thousands*):

	Three Months Ended	
	May 4, 2013	April 28, 2012
Furniture	\$ 171,373	\$ 113,824
Non-furniture	129,964	104,090
Total net revenues	\$ 301,337	\$ 217,914

The Company is domiciled in the United States and operates stores in the United States and Canada. Revenues from Canadian operations, and the long-lived assets in Canada, are not material to the Company. Geographic revenues are determined based upon where service is rendered.

No single customer accounted for more than 10% of the Company's revenues in the three months ended May 4, 2013 or April 28, 2012.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of the financial condition and results of our operations should be read together with the condensed consolidated financial statements and the related notes of Restoration Hardware Holdings, Inc. included in Item 1 of Part I of this Quarterly Report on Form 10-Q and with the audited consolidated financial statements and the related notes of Restoration Hardware Holdings, Inc. included in our most recent Form 10-K filed on April 29, 2013.

FORWARD-LOOKING STATEMENTS AND MARKET DATA

This quarterly report contains forward-looking statements that are subject to risks and uncertainties. Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business. 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 in connection with any discussion of the timing or nature of future operating or financial performance or other events.

Forward-looking statements are subject to risk and uncertainties that may cause actual results to differ materially from those that we expected. We derive many of our forward-looking statements from our operating budgets and forecasts, which are based upon many detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the impact of known factors and it is impossible for us to anticipate all factors that could affect our actual results. Important factors that could cause actual results to differ materially from our expectations, or cautionary statements, are disclosed under the sections entitled Risk Factors in Part II of this quarterly report and in our most recent Form 10-K filed on April 29, 2013, Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this quarterly report. All forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by these cautionary statements, as well as other cautionary statements. You should evaluate all forward-looking statements made in this quarterly report in the context of these risks and uncertainties.

We cannot assure you that we will realize the results or developments we expect or anticipate or, even if substantially realized, that they will result in the consequences or affect us or our operations in the way we expect. The forward-looking statements included in this quarterly report are made only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law.

Overview

We are a leading luxury retailer in the home furnishings marketplace. Our collections of timeless, updated classics and reproductions are presented consistently across our sales channels in sophisticated and unique lifestyle settings that we believe are on par with world-class interior designers. We offer dominant merchandise assortments across a growing number of categories, including furniture, lighting, textiles, bathware, décor, outdoor and garden, tableware and children's furnishings. Our business is fully integrated across our multiple channels of distribution, consisting of our stores, catalogs and websites. We position our stores as showrooms for our brand, while our catalogs and websites act as virtual extensions of our stores. As of May 4, 2013, we operated a total of 70 retail stores, consisting of 62 Galleries, 5 Full Line Design Galleries and 3 Baby & Child Galleries, as well as 14 outlet stores throughout the United States and Canada.

Table of Contents**Basis of Presentation and Results of Operations**

The following table sets forth our statements of operations and other financial and operating data.

On November 7, 2012, Restoration Hardware Holdings, Inc. completed an initial public offering and acquired all of the outstanding shares of capital stock of Restoration Hardware, Inc. Outstanding units under the Team Resto Ownership Plan were exchanged for common stock of Restoration Hardware Holdings, Inc. at the time of its initial public offering. These transactions are referred to as the Reorganization. Restoration Hardware Holdings, Inc. has not engaged in any business or other activities except in connection with its formation and the Reorganization. Accordingly, all financial and other information herein relating to periods prior to the completion of the Reorganization is that of Restoration Hardware, Inc.

	Three Months Ended	
	May 4, 2013	April 28, 2012
	(dollars in thousands, excluding per square foot store data)	
Statements of Operations:		
Net revenues	\$ 301,337	\$ 217,914
Cost of goods sold	199,460	142,646
Gross profit	101,877	75,268
Selling, general and administrative expenses	101,366	77,365
Income (loss) from operations	511	(2,097)
Interest expense	(840)	(1,575)
Loss before income taxes	(329)	(3,672)
Income tax expense (benefit)	(168)	56
Net loss	\$ (161)	\$ (3,728)
Other Financial and Operating Data:		
Growth in net revenues:		
Stores ⁽¹⁾	39%	16%
Direct	38%	20%
Total	38%	18%
Retail ⁽²⁾ :		
Comparable store sales change ⁽³⁾	41%	26%
Retail stores open at beginning of period	71	74
Stores opened	2	3
Stores closed	3	3
Retail stores open at end of period	70	74
Total leased square footage at end of period (in thousands)	796	802
Total leased selling square footage at end of period (in thousands) ⁽⁴⁾	521	522
Retail sales per leased selling square foot ⁽⁵⁾	\$ 284	\$ 200
Direct:		
Catalogs circulated (in thousands) ⁽⁶⁾		14,906
Catalog pages circulated (in millions) ⁽⁶⁾		7,363
Direct as a percentage of net revenues ⁽⁷⁾	47%	47%
Capital expenditures	\$ 9,737	\$ 6,193
Adjusted net income (loss) ⁽⁸⁾	\$ 2,257	\$ (1,325)

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- (1) Store data represents retail stores plus outlet stores. Net revenues for outlet stores for the three months ended May 4, 2013 and April 28, 2012 were \$14.4 million and \$10.9 million, respectively.
- (2) Retail data has been calculated based upon retail stores, which includes our Baby & Child stores and excludes outlet stores.
- (3) Comparable store sales have been calculated based upon retail stores that were open at least fourteen full months as of the end of the reporting period and did not change square footage by more than 20% between periods. Comparable store net revenues exclude revenues from outlet stores.
- (4) Leased selling square footage is retail space at our stores used to sell our products. Leased selling square footage excludes backrooms at retail stores used for storage office space or similar matters. Leased selling square footage excludes exterior sales space located outside a store, such as courtyards, gardens and rooftops. Leased selling square footage includes approximately 4,500 square feet related to one owned store location.
- (5) Retail sales per leased selling square foot is calculated by dividing total net revenues for all retail stores, comparable and non-comparable, by the average leased selling square footage for the period.

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- (6) The catalogs and catalog pages circulated from period to period do not take into account different page sizes per catalog distributed. Page sizes and page counts vary for different catalog mailings. Accordingly, period to period comparisons of catalogs circulated and catalog pages circulated do not take these variations into account.
- (7) Direct revenues include sales through our catalogs and websites.
- (8) Adjusted net income (loss) is a supplemental measure of financial performance that is not required by, or presented in accordance with, generally accepted accounting principles (GAAP). We define adjusted net income (loss) as consolidated net income (loss), adjusted for the impact of certain non-recurring and other items that we do not consider representative of our ongoing operating performance. Adjusted net income (loss) is included in this filing because management believes that adjusted net income (loss) provides meaningful supplemental information for investors regarding the performance of our business and facilitates a meaningful evaluation of actual results on a comparable basis with historical results. Our management uses this non-GAAP financial measure in order to have comparable financial results to analyze changes in our underlying business from quarter to quarter. The following table presents a reconciliation of net loss, the most directly comparable GAAP financial measure, to adjusted net income (loss) for the periods indicated below.

	Three Months Ended	
	May 4, 2013	April 28, 2012
	(in thousands)	
Net loss	\$ (161)	\$ (3,728)
Adjustments pre-tax:		
Management and pre-IPO board fees ^(a)		889
Non-cash compensation ^(b)	3,323	
Secondary offering fees ^(c)	767	
Lease termination costs ^(d)		575
Subtotal adjusted items	4,090	1,464
Impact of income tax items ^(e)	(1,672)	939
Adjusted net income (loss)	\$ 2,257	\$ (1,325)

- (a) Represents fees paid in accordance with our management services agreement with Home Holdings, as well as fees and expense reimbursements paid to our Board of Directors prior to the initial public offering. All management fees were paid in full at the time of the initial public offering. Board fees and expenses subsequent to the initial public offering are not included in the above adjustments and are included in both the GAAP and adjusted net income amounts.
- (b) Includes a non-cash compensation charge related to the performance-based vesting of certain shares granted to Mr. Friedman.
- (c) Represents legal and other professional fees incurred in connection with our secondary offering.
- (d) Includes lease termination costs for retail stores that were closed prior to their respective lease termination dates.
- (e) Assumes a normalized tax rate of 40% for all periods presented.

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The following table sets forth our consolidated statements of operations as a percentage of total net revenues.

	Three Months Ended	
	May 4, 2013	April 28, 2012
Statements of Operations:		
Net revenues	100.0%	100.0%
Cost of goods sold	66.2	65.5
Gross profit	33.8	34.5
Selling, general and administrative expenses	33.6	35.5
Income (loss) from operations	0.2	(1.0)
Interest expense	(0.3)	(0.7)
Loss before income taxes	(0.1)	(1.7)
Income tax expense (benefit)	(0.1)	
Net loss	%	(1.7)%

We operate a fully integrated distribution model through our stores, catalogs and websites. The following table shows a summary of our Stores revenues, which include all sales for orders placed in retail stores as well as sales through outlet stores, and our Direct revenues, which include sales through our catalogs and websites.

	Three Months Ended	
	May 4, 2013	April 28, 2012
	(in thousands)	
Stores	\$ 159,313	\$ 114,676
Direct	142,024	103,238
Net revenues	\$ 301,337	\$ 217,914

Three Months Ended May 4, 2013 Compared to Three Months Ended April 28, 2012**Net revenues**

Net revenues increased \$83.4 million, or 38.3%, to \$301.3 million in the three months ended May 4, 2013 compared to \$217.9 million in the three months ended April 28, 2012. We had 70 and 74 retail stores open at May 4, 2013 and April 28, 2012, respectively. Stores sales increased \$44.6 million, or 38.9%, to \$159.3 million in the three months ended May 4, 2013 compared to \$114.7 million in the three months ended April 28, 2012 due in large part to our comparable store sales increase of 41% in the three months ended May 4, 2013 compared to the three months ended April 28, 2012. Direct sales increased \$38.8 million, or 37.6%, to \$142.0 million in the three months ended May 4, 2013 compared to \$103.2 million in the three months ended April 28, 2012. We believe that the increase in both comparable store and direct sales was due primarily to our customers' favorable reaction to our merchandise assortment, including the expansion of existing product categories and the introduction of new product categories.

Gross profit

Gross profit increased \$26.6 million, or 35.4%, to \$101.9 million in the three months ended May 4, 2013 from \$75.3 million in the three months ended April 28, 2012. As a percentage of net revenues, gross margin decreased 0.7% to 33.8% of net revenues in the three months ended May 4, 2013 from 34.5% of net revenues in the three months ended April 28, 2012.

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This decrease was primarily driven by changes in product mix and strategic pricing on new product introductions. In addition, gross margin decreased due to increased freight costs resulting from a higher percentage of furniture sales during the period, which require greater shipping costs than our other products. These decreases in gross margins as a percentage of net revenues were partially offset by improvement in occupancy costs from leverage on the fixed portion of our store and distribution center occupancy costs.

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Selling, general and administrative expenses

Selling, general and administrative expenses increased \$24.0 million, or 31.0%, to \$101.4 million in the three months ended May 4, 2013 compared to \$77.4 million in the three months ended April 28, 2012.

Selling, general and administrative expenses for the three months ended May 4, 2013 included (i) a \$3.3 million non-cash compensation charge related to the performance-based vesting of certain shares granted to Mr. Friedman in connection with the Reorganization and initial public offering and (ii) \$0.8 million of costs incurred in connection with our secondary offering.

The increase in selling, general and administrative expenses, excluding the one-time and non-cash compensation items mentioned above, was primarily related to an increase in employment costs, an increase in Gallery preopening costs, an increase in credit card fees due to increased revenues, an increase in corporate occupancy costs and an increase in advertising and marketing costs.

Excluding the one-time and non-cash compensations items for the three months ended May 4, 2013 mentioned above, selling, general and administrative expenses were 32.3% of net revenues for the three months ended May 4, 2013 compared to 35.5% of net revenues for the three months ended April 28, 2012. The improvement in selling, general and administrative expenses as a percentage of net revenues was primarily driven by leverage on the fixed portion of advertising and marketing costs, employment costs and professional fees, in each case as a percentage of net revenues.

Interest expense

Interest expense was \$0.8 million in the three months ended May 4, 2013 compared to \$1.6 million in the three months ended April 28, 2012. This decrease was primarily due to the repayment of the term loan in the fourth quarter of fiscal 2012, a decrease in the average borrowings under the revolving line of credit in the three months ended May 4, 2013 compared to the three months ended April 28, 2012, as well as an increase in capitalized interest expense associated with capital projects.

Income tax expense (benefit)

Income tax benefit was \$0.2 million in the three months ended May 4, 2013 compared to income tax expense of \$0.1 million in the three months ended April 28, 2012. Our effective tax rate was 51.06% in the three months ended May 4, 2013 compared to (1.51)% in the three months ended April 28, 2012. The increase in our effective tax rate was primarily due to no longer recording a U.S. valuation allowance against our net deferred tax assets, as well as non-deductible stock-based compensation charges.

Liquidity and Capital Resources

General

Our business relies on cash flows from operations and the revolving line of credit as our primary sources of liquidity. Our primary cash needs are for merchandise inventories, Source Books and other catalogs, payroll, store rent, capital expenditures associated with opening new stores and updating existing stores, as well as infrastructure and information technology. The most significant components of our working capital are merchandise inventories, prepaid catalog, accounts payable and other current liabilities. Our working capital is seasonal as a result of building inventory and paying for catalog costs for the key selling seasons, and as a result, our borrowings are generally higher during these periods when compared to the rest of our fiscal year. Our borrowings generally increase in our first fiscal quarter as we prepare for the outdoor selling season, which is in our second fiscal quarter, and they also generally increase in the third fiscal quarter as we prepare for the holiday selling season, which is in our fourth fiscal quarter. We believe that cash expected to be generated from operations and our availability to borrow under the revolving line of credit or other financing arrangements will be sufficient to meet working capital requirements, anticipated capital expenditures and payments due under our revolving line of credit for at least the next 12 to 24 months. Our investments in capital expenditures for the full fiscal year 2013 are planned at approximately \$95 million to \$100 million, of which \$9.7 million was spent during the three months ended May 4, 2013. Our fiscal 2013 capital expenditures will primarily be related to our efforts to continue our growth and expansion, including construction of Full Line Design Galleries and infrastructure investments.

Table of Contents**Cash Flow Analysis**

A summary of operating, investing, and financing activities is shown in the following table:

	Three Months Ended	
	May 4, 2013	April 28, 2012
	(in thousands)	
Used in operating activities	\$ (19,623)	\$ (8,967)
Used in investing activities	(9,737)	(6,193)
Provided by financing activities	30,653	16,853
Increase in cash and cash equivalents	1,315	1,693
Cash and cash equivalents at end of period	9,669	10,205

Net Cash Used In Operating Activities

Cash from operating activities consists primarily of net loss adjusted for non-cash items including depreciation and amortization, stock-based compensation and the effect of changes in working capital and other activities.

For the three months ended May 4, 2013, net cash used in operating activities was \$19.6 million and consisted of an increase in working capital and other activities of \$29.9 million and a net loss of \$0.2 million, offset by non-cash items of \$10.4 million. Working capital and other activities consisted primarily of increases in prepaid expense of \$44.3 million primarily due to an increase in catalog costs associated with the Spring 2013 Source Book and the introduction of our Tableware and Objects of Curiosity Source Books, and an increase in inventory of \$12.4 million in anticipation of the 2013 spring collection and outdoor selling season. These uses of cash from working capital components were partially offset by increases in accrued liabilities and accounts payable of \$26.0 million primarily due to timing of payments.

For the three months ended April 28, 2012, net cash used in operating activities was \$9.0 million and consisted of an increase in working capital and other activities of \$12.2 million and a net loss of \$3.7 million, offset by non-cash expenses included in net loss of \$7.0 million. Working capital and other activities consisted primarily of increases in inventory of \$24.0 million in anticipation of the 2012 spring collection and outdoor selling season, prepaid expense of \$13.2 million primarily due to an increase in catalog costs associated with the Spring 2012 Source Books, and accounts receivable of \$5.8 million due to timing of payments received related to our credit card receivables. These uses of cash from working capital were partially offset by increases in accrued liabilities and accounts payable of \$20.8 million primarily due to timing of payments, deferred revenue and customer deposits of \$7.1 million due to the timing of shipments made at quarter end, and deferred rent and lease incentives of \$4.4 million primarily due to entering into new lease agreements for Full Line Design Gallery locations and distribution centers.

Net Cash Used In Investing Activities

Investing activities consist primarily of investments in supply chain and systems infrastructure and capital expenditures related to new store openings and improvements.

For the three months ended May 4, 2013, net cash used in investing activities was \$9.7 million primarily as a result of investments in new stores of \$4.9 million and investment in supply chain and systems infrastructure of \$4.8 million.

For the three months ended April 28, 2012, capital expenditures were \$6.2 million as a result of investments in new stores of \$4.3 million and investment in supply chain and systems infrastructure of \$1.9 million.

Net Cash Provided By Financing Activities

Financing activities consist primarily of borrowings and repayments related to the revolving line of credit and capital leases.

For the three months ended May 4, 2013, net cash provided by financing activities was \$30.7 million primarily due to an increase in net borrowings under the revolving line of credit of \$31.5 million resulting from an increase in inventory purchases during the period and capital expenditures related to investments in new stores and our supply chain.

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For the three months ended April 28, 2012, net cash provided by financing activities was \$16.9 million primarily due to an increase in net borrowings under the revolving line of credit of \$18.0 million resulting from an increase in inventory purchases during the period. This overall increase in cash provided by financing activities was partially offset by payments on capital lease obligations of \$1.1 million.

Table of Contents***Revolving Line of Credit***

In August 2011, Restoration Hardware, Inc., along with its Canadian subsidiary, Restoration Hardware Canada, Inc., entered into a credit agreement with Bank of America, N.A., as administrative agent, and certain other lenders. This credit agreement modified a previous facility under which Restoration Hardware, Inc. had a revolving line of credit for up to \$190.0 million as of July 30, 2011. As a result of the modification, the unamortized deferred financing fees of \$0.2 million related to the previous line of credit on the date of the modification will be amortized over the life of the new revolving line of credit, which has a maturity date of August 3, 2016. Under the credit agreement, Restoration Hardware, Inc. has a revolving line of credit available of up to \$417.5 million (following Restoration Hardware, Inc.'s exercise of the commitment increase option on November 1, 2012, as described below), of which \$10.0 million is available to Restoration Hardware Canada, Inc. The credit agreement was further amended in January 2012 to add a \$15.0 million term loan facility with a maturity date of July 6, 2015, which was repaid in full on November 7, 2012, as described below.

Under the credit agreement's commitment increase provision, Restoration Hardware, Inc. had the option to increase the amount of the revolving line of credit by up to an additional \$100.0 million, provided that, among other things, the existing lenders or additional lenders agreed to participate in the increased loan commitments under the revolving line of credit, no default under the credit agreement then existed or would result from such increase and sufficient borrowing base collateral was available to support increased loan amounts. On November 1, 2012, Restoration Hardware, Inc. increased the amount of the revolving line of credit by \$100.0 million pursuant to this commitment increase provision.

On November 7, 2012, Restoration Hardware, Inc. made payments of \$75.7 million on its revolving line of credit and repaid its outstanding term loan of \$15.0 million in full. Such payments were funded from the proceeds received as a result of our initial public offering. Upon the repayment of the term loan in full, we expensed the remaining debt issuance costs of \$0.2 million related to the term loan.

The availability of credit at any given time under the revolving line of credit is limited by reference to a borrowing base formula based upon numerous factors, including the value of eligible inventory, eligible accounts receivable, eligible real estate, and, in the case of the term loan, registered trade names and reserves established by the administrative agent. As a result of the borrowing base formula, the actual borrowing availability under the revolving line of credit could be less than the stated amount of the revolving line of credit (as reduced by the actual borrowings and outstanding letters of credit under the revolving line of credit). All obligations under the credit agreement are secured by substantially all of Restoration Hardware, Inc.'s assets, including accounts receivable, inventory, intangible assets, property, equipment, goods and fixtures.

Borrowings under the revolving line of credit are subject to interest, at borrowers' option, at either the bank's reference rate or LIBOR (or the BA Rate or the Canadian Prime Rate, as such terms are defined in the credit agreement, for Canadian borrowings denominated in Canadian dollars or the United States Index Rate or LIBOR for Canadian borrowings denominated in United States dollars) plus an applicable margin rate, in each case. The weighted-average interest rate for the revolving line of credit was 2.74% as of May 4, 2013.

As of May 4, 2013, \$114.0 million was outstanding under the revolving line of credit. As of May 4, 2013, Restoration Hardware, Inc.'s undrawn borrowing availability under the revolving line of credit was \$138.5 million and there were \$20.2 million in outstanding letters of credit.

The credit agreement contains various restrictive covenants, including, among others, limitations on the ability to incur liens, make loans or other investments, incur additional debt, issue additional equity, merge or consolidate with or into another person, sell assets, pay dividends or make other distributions or enter into transactions with affiliates, along with other restrictions and limitations typical to credit agreements of this type and size. The credit agreement does not contain any significant financial or coverage ratio covenants unless the availability under the revolving line of credit is less than the greater of (i) \$17.5 million and (ii) 10% of the lesser of (A) the aggregate maximum commitments under the revolving line of credit and (B) the domestic borrowing base. If the availability under the revolving line of credit is less than the foregoing amount, then Restoration Hardware, Inc. is required to maintain a consolidated fixed charge coverage ratio of at least one to one. Such ratio is approximately the ratio on the last day of each month on a trailing twelve-month basis of (a) (i) consolidated EBITDA (as defined in the agreement) minus (ii) capital expenditures, minus (iii) the income taxes paid in cash to (b) the sum of (i) debt service charges plus (ii) certain dividends and distributions paid. As of May 4, 2013, Restoration Hardware, Inc. was in compliance with all covenants, and if the availability under the revolving line of credit were less than the amount described above, Restoration Hardware, Inc. would have been in compliance with the consolidated fixed charge coverage ratio described in the previous sentence. The credit agreement requires a daily sweep of cash to prepay the loans under the credit agreement while (i) an event of default exists or (ii) the availability under the revolving line of credit for extensions of credit to Restoration Hardware, Inc. is less than the greater of (A) \$20.0 million and (B) 15% of the lesser of the aggregate maximum commitments and the domestic borrowing base.

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Contractual Obligations

As of May 4, 2013, there were no material changes to our contractual obligations described in the Management's Discussion and Analysis of Financial Condition and Results of Operations Contractual Obligations section of our most recent Form 10-K filed with the SEC on April 29, 2013.

Off Balance Sheet Arrangements

We have no material off balance sheet arrangements as of May 4, 2013.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect amounts reported in our consolidated financial statements and related notes, as well as the related disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management evaluates its accounting policies, estimates, and judgments on an on-going basis. Management bases its estimates and judgments on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions and conditions and such differences could be material to the consolidated financial statements.

Management evaluated the development and selection of its critical accounting policies and estimates and believes that the following involve a higher degree of judgment or complexity and are most significant to reporting our results of operations and financial position, and are therefore discussed as critical:

Revenue Recognition

Gift Certificates and Merchandise Credits

Merchandise Inventories

Impairment of Goodwill and Long-Lived Assets

Stock-Based Compensation

Income Taxes

For further discussion regarding these policies, refer to Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates in our most recent Form 10-K filed with the SEC on April 29, 2013. There have been no material changes to the critical accounting policies and estimates listed in our most recent Form 10-K.

Recent Accounting Pronouncements

See Note 3 *Recent Accounting Pronouncements* to the accompanying condensed consolidated financial statements for a description of certain recently proposed accounting standards which may impact our financial statements in future reporting periods.

Item 3. Quantitative and Qualitative Disclosure of Market Risks

Interest Rate Risk

We are subject to interest rate risk in connection with borrowings under our revolving line of credit and, prior to its repayment on November 7, 2012, our term loan, which bear interest at variable rates. At May 4, 2013, \$114.0 million was outstanding under the revolving line of credit. As of May 4, 2013, the undrawn borrowing availability under the revolving line of credit was \$138.5 million, and there were \$20.2 million in outstanding letters of credit. We currently do not engage in any interest rate hedging activity and we have no intention to do so in the foreseeable future. Based on the average interest rate on the revolving line of credit during the three months ended May 4, 2013, and to the extent that borrowings were outstanding, we do not believe that a 10% change in the interest rate would have a material effect on our consolidated results of operations or financial condition.

Impact of Inflation

Our results of operations and financial condition are presented based on historical cost. While it is difficult to accurately measure the impact of inflation due to the imprecise nature of the estimates required, we believe the effects of inflation, if any, on our results of operations and financial condition have been immaterial.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Principal Executive Officer and our Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of the end of the period covered by this Quarterly Report our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that the information required to be disclosed by us in such reports is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II

Item 1. Legal Proceedings.

From time to time we and/or our management are involved in litigation, claims and other proceedings relating to the conduct of our business, including but not limited to consumer protection class action litigation, claims related to our collection of reproductions, claims related to our employment practices, claims of intellectual property infringement, including with respect to trademarks and trade dress, and claims asserting unfair competition and unfair business practices by third parties. In addition, from time to time, we are subject to product liability and personal injury claims for the products that we sell and the stores we operate. Subject to certain exceptions, our purchase orders generally require the vendor to indemnify us against any product liability claims; however, if the vendor does not have insurance or becomes insolvent, we may not be indemnified. In addition, we could face a wide variety of employee claims against us, including general discrimination, privacy, labor and employment, ERISA and disability claims. Any claims could result in litigation against us and could also result in regulatory proceedings being brought against us by various federal and state agencies that regulate our business, including the U.S. Equal Employment Opportunity Commission. Often these cases raise complex factual and legal issues, which are subject to risks and uncertainties and which could require significant management time. Litigation and other claims and regulatory proceedings against us could result in unexpected expenses and liability and could also materially adversely affect our operations and our reputation.

Item 1A. Risk Factors.

We operate in a rapidly changing environment that involves a number of risks that could materially and adversely affect our business, financial condition, prospects, operating results or cash flows. For a detailed discussion of the risks that affect our business, please refer to the section entitled "Risk Factors" in our most recent Form 10-K filed with the SEC on April 29, 2013. There have been no material changes to the risks listed in our final prospectus.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Not applicable.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

Not applicable.

Table of Contents**Item 6. Exhibits.**

Exhibit Number	Exhibit Description	Incorporated by Reference			Exhibit Number	Filed Herewith
		Form	File Number	Date of First Filing		
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.					X
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.					X
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	XBRL Extension Definition					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					X

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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, thereunto duly authorized.

Restoration Hardware Holdings, Inc.

Date: June 17, 2013

By: */s/ Carlos Alberini*
Carlos Alberini
Chief Executive Officer and Director
(Principal Executive Officer)

Date: June 17, 2013

By: */s/ Karen Boone*
Karen Boone
Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)