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Arhaus, Inc.

Second Quarter 2023 Earnings Conference Call

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Jonathan Matuszewski, *Jefferies*

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Seth Sigman, *Barclays*

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Jeremy Hamblin, *Craig-Hallum*

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PRESENTATION

Operator

Good morning and welcome to the Arhaus Second Quarter 2023 Earnings conference call.

At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal remarks. Please note that this call is being recorded and the reproduction of any part of this call is not permitted without written authorization from the Company.

I will now turn the call over to your host, Wendy Watson, Senior Vice President of Investor Relations.

Wendy Watson

Good morning and thank you for joining Arhaus' Second Quarter 2023 Earnings call. On with me today are John Reed, Co-Founder, Chairman and Chief Executive Officer, Jen Porter, Chief Marketing and eCommerce Officer, and Dawn Phillipson, Chief Financial Officer.

John will start with a summary of the main points we made in this morning's press release, along with operational details. Jen will discuss Rooted, our most recent marketing campaign, and Dawn will cover our financial performance and outlook for the remainder of 2023. After these prepared remarks, we will open the call for questions.

During Q&A, please limit to one question and one follow-up. If you have additional questions, please return to the queue.

We issued our earnings press release and our 10-Q for the quarter ended June 30, 2023 before market open today. Those documents are available on our Investor Relations website at ir.arhaus.com. A replay of the call will be available on our website within 24 hours.

As a reminder, remarks today concerning future expectations, events, objectives, strategies, trends or results constitute forward-looking statements. Actual results or events may differ materially due to a number of risks and uncertainties.

For a summary of these risk factors, and additional information, please refer to this morning's press release and the cautionary statements and risk factors described in our Annual Report on Form 10-K and subsequent 10-Q's, as such factors may be updated from time to time in our filings with the SEC.

The forward-looking statements are made as of today's date, and except as may be required by law, the Company undertakes no obligation to update or revise these statements.

We will also refer to certain non-GAAP financial measures, and this morning's press release includes the relevant non-GAAP reconciliations.

I will now turn the call over to John.

John Reed

Thank you, Wendy. Good morning, everyone, and thank you for joining us today.

It was another great quarter for Arhaus and our business continues to be incredibly resilient. We continue to win with our clients and in the second quarter we again saw exceptional demand comp growth. It is notable that the 11.6% demand comp stacks on a 22.5% demand comp in the second quarter last year. In terms of cadence, we started the quarter in April with a flat demand comp, which accelerated with May and June up mid-teens to low-twenties. We are seeing strength in all categories and in all regions.

We also have a strong start to the third quarter, with demand comp growth in July up high-single-digits.

Turning to highlights for the second quarter, while continuing to execute on our strategic initiatives and growth plan for the year, we delivered net revenue of $313 million; net and comprehensive income of $40 million, with a margin of 12.8%; and Adjusted EBITDA of $64 million, with a margin of 20.4%.

Note that revenue was below our expectations for the quarter, impacted by delivery delays primarily focused on these three factors. First, slower deliveries out of the Dallas distribution center as we continue to optimize product assortment across the three distribution centers. Second, a temporary reduction in productivity as we implemented various new systems, including a new warehouse management system, to drive future efficient growth. And third, some clients are also asking us to delay deliveries as they complete home-related projects.

As we have gone from one distribution center to three in the past two years, it is critical that we continue to implement the system capabilities, processes and talent to enable us to move product through our supply chain more efficiently as we scale for growth.

Some of the factors that slowed net revenue in the second quarter will continue into the second half of this year and as a result, some of that net revenue originally expected in 2023 will be pushed to 2024. This is offset by our stronger than anticipated demand growth. As a result, the midpoint of our year net revenue outlook is unchanged. Dawn will discuss in more detail of this later.

Moving to profitability, we saw a nice earnings benefit from the impact of lower freight costs to our gross margin in the second quarter. This benefit is enabling us to pass through some of the lower pricing to our clients, with a particular focus on ensuring we remain top of mind competitively. It is also allowing us to optimize our assortment as we make way for new product launches in the fall, and address areas where we need less inventory on hand.

Additionally, with our stronger earnings, in the second quarter, we are raising our full year net income and Adjusted EBITDA outlook.

Turning to an update on our Showroom growth for the year, we are successfully scaling our Showroom footprint along with executing our renovation, relocations and expansion projects.

To date, we have opened five new Showrooms in 2023: two new Design Studios in Asheville, North Carolina and Naperville, Illinois; two traditional Showrooms in Topanga, California and Peabody, Massachusetts; and a new outlet location in Dallas.

We are very pleased with the strong performance of our new showrooms and proud of how they showcase our incredible product.

For the balance of the year, we expect to open six additional traditional format showrooms: a West Hartford, Connecticut location in the third quarter and full veer new showrooms in the fourth quarter: Coral Gables, Florida; Huntington Station, New York and three new showrooms in California; an additional planned California Showroom opening has pushed to 2024.

Our renovation, relocation and expansion projects are all proceeding as expected.

I encourage all of you to visit one of our showrooms and see and experience our product for yourselves.

We also continue to grow our in-home designer program. We are focused on the growth of this program, as the average order value we enjoy from our in-home designer assisted sale is four times our company average order value.

I founded Arhaus more than 35 years ago with the objective to source wood sustainably and to create heirloom quality furniture with the hope that it will be passed down from generation to generation and not end up in landfills. I have always been passionate about preserving our planet, and now more than ever, we must do our part to help slow down global warming. I am proud to announce a $10 million commitment to The Nature Conservancy to support their efforts to protect the critical rainforests in Borneo, Indonesia.

Our donation will directly support The Nature Conservancy, and their local Indonesian affiliate, Y - KAN, as they embark on an ambitious project to pilot solutions to drive more attractive and self-sustaining economics in forestry.

We are proud to support these efforts, and we hope others will join us. We know that the environment is critical to our business, our employees, and our clients and certainly the planet. And we know that we must take bold action now.

We look forward to sharing this incredible journey with you, and we are confident that together, we will make a difference.

Finally, I want to thank my team for their continued focus on providing an incredible product assortment, an amazing omni-channel experience, and client-first service, as well as executing our Showroom openings and enhancing strategic systems that will allow us to scale for long-term growth and success. It is their execution that makes me confident in our ability to capitalize on the significant opportunities ahead of us.

Now I'll turn it over to Jen to discuss Rooted, our latest company, marketing campaign.

Jen Porter

Thank you John, and good morning everyone.

I would like to take a moment today to celebrate our latest campaign, Rooted, which launched yesterday across our channels. Last year, we sent a team of writers, videographers, and photographers to Mexico. The goal of their trip was unique - to visit artist and longtime Arhaus partner, Javier, and to capture the magic happening in his workshops.

From the beginning of our partnership, Javier's handcrafted furniture has been different. Distinctive. Working only with salvaged and sustainably sourced wood, he sees the specialness of every log and lets their organic imperfections drive his inventive designs. As our businesses have grown together over the years, so has our collaboration. Our senses of style evolved and refined. We've developed new collections and expanded our offerings into new spaces of the home.

Rooted is a truly immersive campaign that tells Javier's story: his family, his process, and his passion for the trees. It is also volume one of the story of who we are. I encourage you to visit arhaus.com to experience the campaign for yourself.

We are so proud to partner with Javier, and with all of our artisan partners around the world, to offer our clients the most beautiful and the most unique handcrafted furniture collections. We hope you enjoy the stories within Rooted as much as we enjoy telling them. And we look forward to continuing to share the stories which make Arhaus so very special.

In addition to Rooted, we have some great marketing initiatives launching in Q3. Our new content experience on Arhaus.com entitled Unabridged launched last week. Here you will find the wonderful stories of our Artisan partners, alongside design inspiration, partnerships, and much, much more. We will also be launching our Fall campaign in just a few weeks, offering hundreds of new products and expansions of some of our best collections. We cannot wait to hear client feedback and to share more updates with you on upcoming calls.

For now, I'll pass over to Dawn Phillipson.

Dawn Phillipson

Thank you and good morning. As John described, we are pleased with performance in the second quarter.

Key items from our second quarter 2023 income statement include:

Net revenue of $313 million, up $7 million or 2.2%, with comp growth of negative 0.8%, and demand comp growth of 11.6% on a one-year basis, and 102.3% on a four-year stacked basis.

Gross margin increased 5% to $140 million in the quarter, driven by our higher net revenue and lower product costs, partially offset by higher fixed Showroom costs and higher credit card fees related to increased interest rates and demand.

Gross margin as a percent of net revenue increased 140 basis points to 45%, primarily reflecting favorable product costs, partially offset by higher fixed Showroom costs and credit card fees.

Second quarter SG&A expense increased 4% to $86 million. The increase was primarily driven by higher corporate expenses to support the growth of our business and higher selling expenses related to new showrooms and strong demand, partially offset by lower product storage fees as we have expanded our warehouse capacity.

Second quarter 2023 net income increased 10% to $40 million.

Adjusted net income in the second quarter of 2023 increased 3% to $40 million compared to adjusted net income of $39 million in the second quarter of 2022, primarily driven by the factors just described.

Adjusted EBITDA in the quarter increased 5% to $64 million from $60 million in the second quarter of 2022.

Second quarter 2023 net revenue of $313 million and Adjusted EBITDA of $64 million dollars resulted in a 20% Adjusted EBITDA margin in the quarter, an increase of 70 basis points year-over-year.

Let me now move now to our outlook and how we are thinking about the second half of this year.

As the midpoint of our narrowed net revenue range implies, we expect second half net revenue to be down mid-single-digits versus the second half of 2022, with the higher than anticipated demand comp growth we are experiencing offset by the factors John described earlier that affected our Q2 net revenue growth.

We expect to see demand comps increase in the low-to-mid-single digit range in the second half of the year.

On the profitability side, the freight benefits we are realizing enable us to increase our full year net income and Adjusted EBITDA guidance, while also funding the pricing adjustments John described, and our $10 million donation to The Nature Conservancy.

We expect Adjusted EBITDA margin to be down approximately 750 to 850 basis points in the second half of 2023 versus the second half of 2022, due to: reduced leverage as compared to the second half of 2022 when we benefited from substantial backlog deliveries; higher Showroom rent impacted by both the number of new Showrooms and strong demand; higher Showroom staffing; investments to enhance omni-channel and technology capabilities, including information technology and warehouse management systems infrastructure; and the previously mentioned donation to The Nature Conservancy.

Accordingly, as we announced this morning, for the full year 2023, we are narrowing our net revenue outlook, with our midpoint unchanged, and increasing our net income and Adjusted EBITDA outlook.

We expect full year net revenue of $1.25 to $1.29 billion, representing growth in the range of 2% to 5%; full year comparable growth in the range of negative 2% to positive 1%; net income of $102.5 to $112.5 million; and Adjusted EBITDA of $187.5 to $197.5 million.

For all other details related to our results and our 2023 outlook, please refer to our press release.

In closing, we are pleased with the first half of 2023. We believe our strong, debt-free balance sheet, coupled with a strategic growth plan to build on our share gains in the highly fragmented $100 billion premium home furniture market, position us to weather any economic cycle and emerge in an even stronger position, poised to deliver on our longer term growth plans and drive value for all stakeholders.

Thank you for your attention, and we would now like to open the call up for questions.

Operator

Thank you. At this time we will be conducting a question-and-answer session. (Operator Instructions)

Our first question is from Steven Forbes with Guggenheim Partners.

Julio Marquez

Hey John, Dawn. This is Julio Marquez actually on for Steven Forbes. Just a quick question. Given the ongoing strength and underlying demand trends, I was hoping you could give us a brief preview on your real estate plans for 2024, as well as the new product pipeline. And as a quick follow up, how is the mix of in-stock versus special order sales evolved over the past couple of years, and what infrastructure-related investments are still outstanding over the, I guess, intermediate term to ensure the customer experience is where it needs to be? Thank you.

John Reed

Hey, good morning. Thanks for the questions. Yes, as far as new stores go for 2024, we're on track to stay with our plan, which is as we've been saying, five to seven stores a year, and we'll look at opportunities that may present themselves and maybe do a little more or maybe do a little less depending on finding the right real estate and finding the right deals, of course.

As far as you asked about the mix of special orders, it's right on track with what we're planning. It's been strong. We feel we -- it's one of our very unique parts of Arhaus that makes us very competitive. It is our custom, especially in the upholstery business, since we own our own upholstery factory, we're able to give consumers really, really great fabrics, different looks, very, very different than we see out there in the market, and we can custom order it and make it very quickly for our clients. So we're very, very happy with that part of the business.

Is there a third part?

Julio Marquez

Yes, (multiple speakers). Yes, just very quickly. If you can follow up with anything on infrastructure-related investment (audio interference) short to more intermediate term?

Dawn Phillipson

Thanks. You cut out there for a second. Was that a question about systems, infrastructure? Is that -- okay. Yes, we're excited. We have a lot of opportunities to continue to enhance the systems, infrastructure that we have in place. As we've grown over the last several years, we know that there are more efficient ways to do things and we have a really strong management team here as we're driving some change and some nice -- it's going to facilitate some nice, strong, efficient growth. So, as we're thinking about the next several months, we have a warehouse management system that has been deployed in one of our distribution centers. We're working to deploy another one for our main Ohio facility here.

So, really excited to see how that's going to continue to progress over the next several months. And then we have several smaller ones. I know we talked in the past about planning software programs. And then just various other projects that we're working on to continue to drive efficient growth within the organization.

Julio Marquez

Awesome. That is helpful. Thank you very much.

Dawn Phillipson

Thank you.

Operator

Our next question is from Jonathan Matuszewsk with Jefferies.

Jonathan Matuszewsk

Hey, good morning and thanks for taking my questions. The first question was just on the guidance framework for the second half. Historically, you've suggested the bulk of your demand is driven by light home refreshes and then also more complex contractor-assisted refreshes and a smaller piece is driven by existing home sales. So just wanted to get your underlying assumptions for those three drivers in the second half. Curious how you're thinking about whether those stay consistent with recent trends, improve or worsen? That's my first question. Thanks.

Wendy Watson

Hey Jonathan. This is Wendy. Yes, I mean, those are the primary drivers. We never know exactly how they're going to play out from time to time, but our assumptions are that they will continue -- those same factors will continue to be the primary purchase drivers related to housing for our clients. Understanding too, we have all of this incredible product that's coming in. But I would say our assumptions in general have not changed regarding those three factors.

Jonathan Matuszewsk

Okay, got you. And then my follow-up question is just on pricing. You've done three rounds of hikes over the last couple of years. Relative to peers, you haven't been as aggressive. So I thought John's comments about lower supply chain costs enabling lower price points for clients was interesting. Maybe if you could just expand upon the lower price points that you're passing along to customers, that would be helpful. Is it being driven by more promotionality in the industry, competitor actions, etc.? Thanks so much.

John Reed

Sure. Yes, I mean, we've always ran our business in the belief of giving customers a great value for their money. We have a little different business model than most people out there and that is, we buy direct from manufacturers, we cut out all the middlemen, the wholesalers, the salesmen and all of that kind of stuff that a lot of people build into their price. So, we've always felt that if we can give our customers and clients a better value -- if prices go down, we do, if prices go up, we raise prices, and we raised prices for quite a while there. The better values we're getting now is really in the freight costs. It's container cost that come way down compared to certainly a year ago, a year and a half ago.

So, those are the things that we're impacted with that. We're looking at every price. If we can take some down a little bit and still withhold our margins, which obviously is number one, we'll do it, and if that'll help our volume, because prices have come down a little bit, it's great. But we're doing it very selectively and we're not trying to chase customers with lower prices or anything. And it seems to be working for us. So, we're going to keep marching at that. I don't see container costs coming down more than they are now, because they're very, very low. So I would think in the future prices will be more maintained. We're not going to have to raise them more or lower them. So, that's kind of what the future looks like.

Dawn Phillipson

Jonathan, I have just a couple of other points that you might find helpful. So, we implemented the price actions in mid June, so limited impact of those in the second quarter. Overall, on the full assortment, it's about a mid single-digit price decline. But keep in mind that most of those are temporary as we're looking to right-size the inventory assortment and as we're thinking about how to make way for newness within the assortment as the newness season is coming up for us.

So, really excited for that. Those were the two points. So, thanks, Jonathan.

Jonathan Matuszewsk

Super helpful. Best of luck.

Operator

Our next question is from Simeon Gutman with Morgan Stanley.

Jackie Sussman

Hey guys. This is Jackie Sussman on for Simeon. Thanks so much for taking our question. Just on the timing of deliveries, I guess, how important is it for your business to be more consistent with that timing of deliveries? Do you think you're impacting the brand in any way, and kind of what's the path to marry up the demand and the actual comp? Thanks so much.

Dawn Phillipson

Sure. So for the delivered sales, like we mentioned, there have been a couple of impacts in the second quarter that were impacting our ability to deliver the demand that’s been written kind of to the level that we had anticipated originally. We're working through the second half to be able to fulfill those orders based off of clients' timelines as well.

So, I would say, more to come on the alignment of those two. I think when you're looking at just the demand comp percentage and the comp percentage, keep in mind the base is going to be very different looking at last year. So, there's going to be some noise until there's a lapping of normalization. But we're working pretty diligently to get product delivered into the clients' homes in the second half of this year, particularly in advance of holiday seasons when folks really want their homes looking perfect.

John Reed

Jackie, just to fill in. You had asked if this has any impact on anything. We're selling handmade heirloom quality products and they're not -- this isn't a commodity. So, when folks order our product and if it takes another couple of weeks to get to them, it's fine. We're seeing absolutely zero cancellations in product or so forth because we're delayed or something like that. And that's very important to know, is our clients will wait for our product because they know they're going to have it for many years, it's very unique, they can't find it anywhere else in the world, and they'll wait for it. They may like it a couple of weeks earlier, but if -- so be it, then they'll wait for it and it's not a big deal for them.

Jackie Sussman

Got you. Thanks so much. Just a quick follow up. I guess on new store productivity, can you remind us what year one productivity looks like in new space as a percent of an average store and how are new galleries tracking on that?

Dawn Phillipson

Yes. So what we said is that for traditional showrooms, we target a minimum revenue of $10 million, and Adjusted EBITDA contribution of 32%. So, we're really -- we feel really good about how our new showrooms are performing relative to those metrics. And they come out of the gate really strong. What we found is that we excel really well in any market that we enter. So whether it's urban, suburban, whether we're in a mall or a lifestyle center or standalone. So, we feel pretty strongly in not only the showroom experience but the marketing that we put behind it when we open a new location.

So, really proud of how our new locations are performing to date.

Jackie Sussman

Got you. Thanks so much.

Operator

Our next question is from Peter Benedict with Baird.

Hello, Mr. Benedict.

Peter Benedict

Sorry about that. Hey guys. Good morning. So, Dawn, can you talk a little more about maybe the second half outlook to help us understand your Q1 gross margin versus SG&A. Certainly looks like gross margin will be down or SG&A's going to be up a bunch. Just trying to understand what the puts and takes are there and any kind of callout around 3Q versus 4Q just as we set the expectation for the back half. That's my first question.

Dawn Phillipson

Yes. Good morning Peter. So, while we don't guide to gross margin or SG&A, I'd be happy to provide some clarity on some of the components. So, within the gross margin line item, we did talk a bit about freight is coming down and we're seeing that starting to roll through the P&L. So that's some nice relief there. We're offsetting that with pricing actions that we've taken for the inventory assortment.

Other items rolling through there, of particular note are the new showrooms. As we're opening six new showrooms in the back half, keep in mind that those are in more expensive locations and have rent in advance of opening. We also, within a couple of months prior to opening, we're starting to staff those locations as well. And there's no corresponding top line revenue impact. So, that's important. Now it sets us up really well for 2024 and beyond for these new showrooms, but those have a near-term impact for this year.

We're also seeing a little bit compression still in credit card fees, as you can imagine with the interest rates where they are and with demand accelerating that that impacts those line items.

Within SG&A, so staffing of the new showrooms rolls through SG&A, but we're also expecting some variable compensation increases. Keep in mind that our showrooms are commissioned based off of demand versus GAAP revenues. There's a little bit of a disconnect there. So as we're working to get the delivered revenue out the door, there could be some just variances there on a percentage basis.

We're also investing in systems. As we talked about, the warehouse management system, the planning systems, we're talking about an order management system. So, a lot of those in advance of actually turning on the system. There's a lot of cost and implementation fees that go along with those.So, yes, I think we're investing for growth. We're excited about where these systems are going to take us over the next 12, 18, 24 months and how we're going to be able to grow the business and support the growth that we've seen, but certainly kind of a near-term compression.

And then just as we're thinking between quarters, again, we don't really give quarterly guidance at this point. But, I don't know, Wendy, do you have maybe any additional context?

Wendy Watson

No. I mean, other than we would hope that -- it's a nice split. Obviously, in the third quarter, we have the launch of our new products and the refresh in our showrooms and the big Fall marketing campaign that can give us a little bit of a lift in the fourth quarter, depending on delivery. But in general, I would think about them as fairly even.

Peter Benedict

Great. That's super helpful. And then, I guess, the next question would just be around the COO...

Wendy Watson

Peter, one other note. So, also, in SG&A, we'll have the donation to TNC, and that's likely to be in the fourth quarter.

Peter Benedict

Excellent. That's really helpful guys. Thank you. My follow up would be on the COO departure. Can you talk a little bit more about that, give us some context. Obviously, given your drive to become more efficient around supply chain and logistics, just what your plans are there from a management standpoint? Thank you.

John Reed

Yes. We've got a great, great team driving the back part of the business. The COO mutually agreed - it just wasn't a great fit to take us forward. So, we're going to keep moving on. We'll figure out what our plans are for the future. But we've got a great, great team on the ground that can execute, and we'll move forward with them and keep things going.

Peter Benedict

Got it. Thanks so much guys. Good luck.

John Reed

Thank you.

Operator

Our next question is from Seth Sigman with Barclays.

Seth Sigman

Hey, good morning everyone. I wanted to follow up on the price adjustment conversation. So, it's really difficult to compare apples-to-apples versus your competitors, but do you have a feel for, you know, following some of these adjustments and what the price gaps look like, and maybe just any other commentary around what's happening competitively from a price and promotional perspective? Thank you.

Dawn Phillipson

Yes. So, we'll constantly evaluating where we're positioned within the competitive set, making sure that our value proposition is exactly where we would like it to be, making sure that we're kind of top of market with regards to that. So, we feel really comfortable with some of these price adjustments that we've taken that would not be temporary, that would be more permanent based on what we know today. We feel great about how those position us within the market, and I think as we're looking across the assortment, we have really unique product with a really great quality.

So, I think we're really pleased with how we're positioned in the market. But we're constantly evaluating that as well.

But Jen, do you want to talk about the promotional cadence you've seen?

Jen Porter

Yes. I mean, I think to touch specifically on promotions, similarly to, as I mentioned on prior calls, we're continuing to see that heightened promotional activity. Our promotional strategy remains unchanged. We continue to be really happy with it. I think the one thing to note, our promotional strategy, so you know, we've always been running those promotions around those holiday weekends, those three-day weekends and started talking towards the end of last year, right around that Black Friday time, about how we were seeing those sales periods lengthening. So, I think as we are in growth mode, we do want to be top of mind and part of the consideration set for those customers who are more promotionally driven. We have lengthened some of our promotional periods. So, what might have been a three- to four-day promo around July 4th weekend, might now be a little over a week, in line with what we're seeing with trends in the market. Again, that's really -- we are in growth mode. We are trying to grow our brand awareness. We know that a subset of our clients are promotionally driven and we want to be in that consideration set when they're out there in the market and shopping.

But like I said, no changes to the strategy other than that and we continue to be really happy with the performance.

Dawn Phillipson

And just as a reminder that those price changes went into effect in mid June.

Seth Sigman

(Audio interference) specific you would point to that you guys are doing or do you think maybe that's (audio interference), just any more context there. Thank you.

Wendy Watson

Seth, this is Wendy. You broke up a bit. Can you repeat the question?

Seth Sigman

I'm sorry about that. Just the acceleration that you saw in demand (audio interference) throughout the quarter, was it (audio interference) acceleration, I think one year basis and now multiyear basis as well. Is there anything (audio interference) or do you think maybe that's just a (audio interference)

Wendy Watson

Seth, you're still breaking up. But I think your question is about the demand acceleration in the second quarter and what we saw and how impressive it is on a multiyear basis.

Dawn Phillipson

Yes. So we're (multiple speakers)

Seth Sigman

Yes, (multiple speakers)

Dawn Phillipson

Go ahead, Seth.

Seth Sigman

No, sorry about that. Yes, and if there's anything specific that you did to drive that acceleration or do you think it's the market? Thank you.

Dawn Phillipson

Well I certainly think we're driving some of that. I think there's probably a market component as well, but we're continuing to execute on the strategies that we've outlined and talked about really for the last several years. So, we feel great about our showrooms, the aesthetic, our product is really resonating, it's on point. We continue to introduce newness throughout the last several years, which is a little bit different than perhaps some other folks in the market.

So we feel great about that. We certainly are constantly looking at our marketing touch points and evaluating are there different ways to engage with the clients to drive responses. So, I think we're executing on what we've laid out that we'll execute and we'll continue to do that and we're just really proud of the results and proud of our teams being able to drive the results.

Operator

Thank you. Our next question is from Max Rakhlenko with TD Cowen.

Max Rakhlenko

Great. Thanks a lot. So, first, gross margin was up nicely in the quarter, but just want to confirm that the lower prices will not result in gross margin pressure down the road. And then how much do you think the pricing impact will have on 2H, and then just the elasticity that you've seen over the past handful of weeks?

Dawn Phillipson

Yes. So, as we've mentioned, we're reinvesting the freight savings as they're flowing through the P&L into some of these price actions that we've taken. We feel now is the right time to really evaluate, dig into our inventory assortment and make sure that we are positioned how we want to be positioned heading into the back half of this year into next year and then go forward, especially as there's renewed focus on our supply chain footprint with multiple DCs.

So, we're spending a lot of time reviewing and analyzing that and think it's an opportunistic time to take some pricing action to drive those units, especially given that there's the ability to do so without margin impact, given the freight rolling through the P&L.

We also said that this freight savings are enabling us to contribute to The Nature Conservancy which we're really excited about and proud to partner with. So we're feeling good about that.

Sorry, was there a second part of your question?

Max Rakhlenko

Just the elasticity that you're seeing. So how are customers reacting to the price cuts?

Dawn Phillipson

Yes, I mean, I think as far as -- so I'll answer this maybe in a slightly different way and tell me if this helps you. But the consumer response has been good. Price doesn't drive the client however. So, as we're thinking about it, there is a subset of the client base that will purchase -- maybe they were waiting for a promo, maybe they were waiting for the next sale of our holiday weekend, but our client wants the product that they want based on the aesthetic and based on the quality and based on their home and what fits their lifestyle.

So, we've seen some great response to some of those products that we're showcasing, and we're showcasing them a little bit differently as well. So, as we're looking about driving that inventory through the supply chain to the client, it's about pricing a little bit, but it's also about how do we engage with the client and around those products as well. So, things like changing how they're displayed on the website in the navigation. So, I think we're looking at all kind of aspects but the client is engaging with the product regardless of price point, which we're really excited and pleased with.

Max Rakhlenko

Got it. Okay. And then can you remind us, how much newness are you going to introduce in the second half of the year, and then just what you're thinking for next year as well? I know that you typically have a cadence, but just curious if you're sticking to it or if we should maybe any changes? And then just with that, how you're thinking about the timing of all of your -- the book roll-out?

John Reed

Yes, I can answer that, Max. As you know, I think our demand sales were up, what, 33% over the last 24 months. Clearly, our product is resonating with our clients and we've got great products. So, during the pandemic I had our merchants not slow down designing, developing, sampling new products, so when we came out of the pandemic we could pull a trigger on those and they were ready to go and we're seeing a lot of that. We think that is a big part of why we're doing so great. I know it is, because we've got great, great products.

So, the future we're seeing staying steady. We shoot for about 20% newness a year and we're staying steady with that point. We're looking at every single category that we carry and trying to just get better and better everyday.

We've got such a great merchant team, great design team, and they're very passionate and so talented that -- they love working on product and so do I, and we keep coming up with better and better things that we think are cutting edge, people I know have never seen anywhere else. Take a look at this Rooted campaign that Jen just alluded to. One of our key partners that we did roll out some really cool, new product with this Fall are rolling out right now, I should say, that we know is going to be a home run. So we're staying on course.

Dawn Phillipson

And Max, I would also add that that newness that's coming in is coming in at really exciting margins. So, we're really proud of how we're able to price those pieces with the market.

Max Rakhlenko

Can you maybe just elaborate on that, if you don't mind, just that last comment?

Dawn Phillipson

I mean, Max, I think we don't want to go too much into detail, mostly for competitive reasons, right. But I can tell you that I guess as you're looking at the overall assortment and the pricing, we've got newness that's coming in, really strong price points, really great margin, and then we have -- we mentioned the mid single-digit price adjustment that we've taken. I also would provide a little more clarity that in addition to most of those being temporary that it also is contingent upon the stock levels. So, while it's mid single-digit across the assortment, as you're thinking about maybe we have more months of supply than in some categories than others and we've taken higher pricing on those than others.

So, I think -- overall, I don't know that you can really model this out, but just know that we're focused on margin management and we feel really good about how we're positioned with the client but also from an P&L perspective.

John Reed

Yes, and just to add on to that. From a merchant side, we work on new product and roll out new product that's going to be profitable. We're not -- I'm not interested in chasing cheaper products, let's cheapen the quality of the products so we can sell more, so we can hit a lower price point, or say we cheapen it so we can get a higher margin. That's absolutely not what we do. But we keep the quality as absolutely good as possible, great design. And I think we analyze the product. We go through hundreds of products that we pass on because maybe we can't get the margin on this cool stuff, but we feel it's over priced.

So, anything we do roll out, to Dawn's point, is great product at a great value, and we're getting a good margin on it, because that's number one and that's just our philosophy and how we merchandise products.

Max Rakhlenko

Great. Thanks a lot.

Operator

Our next question is from Jeremy Hamblin with Craig-Hallum.

Jeremy Hamblin

Thanks, and congrats on the strong results. So, you guys just posted, I think, your best gross margin rate. I think that your expectations are for that to come in a bit here in the second half of the year. But just not to belabor the point here in asking more questions about the gross margin, but it seems as though you've had a step-up, a sustainable step-up in terms of what the long-term gross margin outlook picture is and whether or not -- I just wanted to see, like clearly scale is part of this, maybe scale also with the vendors is playing a big part in that, but the ability to offer those kind of the price adjustments, mid single-digits, it sounds like you're still kind of targeting a gross margin that is sustaining at a higher level than, let's say, kind of a few years ago. Any additional comments that you can share on kind of that viewpoint and maybe the key -- biggest key drivers of that sustainability on the gross margin.

Dawn Phillipson

Yes. So, I think you articulated that nicely in that there's a lot of opportunity as we continue to scale the business, and what we said in the past is that we expect to grow Adjusted EBITDA but it may not be a linear path. So ,as you're thinking about those margin rates, we're investing in our showroom footprint. Those are costly. In advance, six to 12 months in advance of actually opening the showroom. We're also lapping, particularly in the back half of this year, in Q4 in particular, we're lapping some really strong backlog delivery last year. So, keep in mind that last year we saw great leverage on those fixed expenses that we're not going to have that same benefit this year.

So, I think it's just important to keep in mind, in '22, the backlog was about $150 million and what we said is that the flow-through rate on that was between 35% to 45%. So, really strong flow through on that. About $100 million in backlog delivery in '23, '24, depending on how the back half of this year plays out. So, if you're thinking about longer term, backlog is certainly going to play a role, a significant role in those rates. But we are positioning the Company really well to continue to grow as we're investing in talent, we're investing in systems, we're investing in processes, and certainly in product as we continue to work really closely with the vendors around pricing those pieces.

So, I think more to come on that from a larger perspective, but we're excited about where the Company is heading, and we feel really good about how we're going to be able to deliver over the near and medium term.

Jeremy Hamblin

Got it. Thanks. And then just a follow up here on the new showroom openings here. The upcoming markets are really kind of coastal markets, slightly higher household income markets. In terms of expectations around that you noted kind of that $10 million bogey. Are you seeing, are the expectations for the unit level economics' higher, given that likely rent costs are a little bit higher in those marketplaces as well, do you have to set that bogey even a little bit higher to get the unit level economics you want.

Dawn Phillipson

Yes, you're exactly right. So, we're targeting a 32% Adjusted EBITDA contribution in year three for all of our showrooms. Now that's an average. So, as we're thinking about some of these showrooms, particularly in California, a California showroom depending on the demographic, which location we're going into, it's going to perform better than perhaps like an Akron/Canton in Ohio. So, we're very laser-focused on the financials of each location, and we're really pleased with the deals that we've been able to get and the performance that we expect and anticipate coming out of -- or entering some of these new markets and then adding new locations within existing markets.

So, we're definitely focused on the financial performance of each location.

Jeremy Hamblin

Thanks for the color. Best wishes.

Dawn Phillipson

Thank you.

John Reed

Thank you.

Operator

Our next question is from Peter Keith with Piper Sandler.

Peter Keith

Hey, good morning everyone. Congrats on the demand acceleration. It's pretty impressive. I'm going to first kick it off to Jen on the Rooted campaign. I did notice that earlier this week it's a really impressive video. So, maybe just give us the plan. How do you raise the awareness of that, push that out to customers to help increase that profile of the Acacius and Polanco collections because it does seem like it could drive quite a bit of interest?

Jen Porter

Yes. Good morning, Peter, and thank you. We are thrilled with the campaign. As I mentioned it launched earlier this week and can be found on arhaus.com, our website, in our stores, on our social media channels. We're doing some advertising out in the market to prospect for new clients who might be getting introduced to Arhaus for the first time, working with some of our partners and influencers to get that message out as well. So, we're really excited to see how this plays out.

I think what is so incredible about this particular campaign is it's really expanding on the stories and what is special about Arhaus and what we have known since the beginning. I think one of the great things that we hear from our design consultants and interior designers is clients want to know the stories of the artisans behind the product that they are buying. They want to know where they come from, how they're made, how they're crafted, what materials they're made out of, any sustainability elements to that.

So, we've always loved telling these stories on a one-to-one basis in showrooms, but this is our ability to really do it, like you said, on a broader scale. We also have printed a limited edition, incredibly beautiful book that will be going out to some of our top clients, will be available in our showrooms, and it's just an absolutely stunning work of art. As I mentioned earlier on the call, we really sent some incredible artists and creators to Mexico to capture the story of some incredible artists and creators in Mexico and it's just we know are really incredible as soon as you're watching that all come together and we're really excited to start seeing reactions from both our clients, from our internal employees and then from new people who are getting to know us for the first time.

I think the other two things I just want to note is, as I mentioned earlier on the call, this is volume 1. So, we have a lot of stories to tell, a lot of elements, a lot of partners, a lot of product that really combines to make Arhaus incredibly special. So, looking forward to continuing this campaign in the future. And then our Fall campaign launches in the next few weeks. As I mentioned, the Fall catalogs will be hitting homes in about two weeks here. And that is incredible. That is showcasing all of the products and the stories and the details.

And so just really excited for that sort of one-two punch there of layering the positional storytelling element onto our marketing initiatives.

Peter Keith

Okay, that's great stuff. Thank you. My second question, I guess, I'll ask this to Dawn. So, the increase in the EBITDA guidance particularly impressive if we adjust out that $10 million charitable donation, but the midpoint of sales guidance, and there's some puts and takes to that midpoint sales guidance holding steady, so it suggests something's kind of better on the margin front than what you're expecting. Could you give us a little more color on what's playing out to help the margin EBITDA growth?

Dawn Phillipson

Yes. So, we've seen really nice flow through on the freight front primarily as we're thinking about gross margin. So, for us, even within the organization, we have a little bit of challenges in seeing and forecasting exactly how that freight impact is going to flow through just because it's SKU dependent, and that's really contingent upon what client is purchasing at what volumes. So, we've been a little conservative in how we're thinking about freight flow through in the P&L, I think.

And so we saw some nice response there and it's enabling us to do some other things. I think we're very thoughtful about how we're continuing to invest in the organization from a talent front. Especially with so much macro uncertainty, we want to make sure that we're staffed appropriately, not overstaffed, as we're thinking about investments within the business, just making sure that we're being really financially prudent and thoughtful about the timing of those as well. So, I think it's some management by a really strong management team and our fiscally minded management team, in combination with the freight flow through.

Peter Keith

Okay. Terrific. Thanks so much guys.

John Reed

Thank you Peter.

Jen Porter

Thank you Peter.

Operator

Our next question is from Curtis Nagle with Bank of America.

Curtis Nagle

Good morning. Thanks for the question. Just wanted to clarify a point, John, I think you made earlier in the call, calling out what sounds like customers asking to delay as they're completing home projects. Yes, I was a little surprised by that. Are we worried that we might see cancellations, or just what's going on there?

John Reed

What's going on is our clients are still renovating their homes and building second homes and so forth. And I'm not a builder, but invariably builders are delayed. Absolutely zero cancellations we're seeing on this. The percentage is so small it's not even worth talking about. But yes, it's just the same old thing that clients are renovating, like I said, a lot of new homes are still being built, at least for our clients there. They may be delayed a couple of months, two or three months on finishing up their homes. So, obviously, they can't take the furniture until the room or home is ready. But nothing different than has been in the past. Obviously, COVID, there was more delays because even more people were building and so forth. But no, we see it as a positive thing. It's just a timing issue, that's all it is. Absolutely, it's just a timing issue.

Curtis Nagle

Okay. It sounds like that all came through. Anything to think about in terms of carrying inventory, in terms of modeling?

John Reed

Carrying?

Curtis Nagle

Yes, in terms of are you going to be holding more inventory as a result, maybe just temporarily, and yes, as you think about in terms of the modeling.

John Reed

Well when clients purchase, we get a deposit from them and we hold their inventory for them, absolutely. But we're buying inventory prudently according to our sales. We look at it SKU by SKU and we try to keep -- our concept is we try to keep inventory in stock so if clients do want it right away we can deliver it to them, and if they don't want it for two or three months we'll still hold it in our warehouse for them and we deliver it when they're ready.

Curtis Nagle

Okay. All right.

John Reed

But we're not adding inventory for any reason, no.

Curtis Nagle

Yes. Okay. Thanks John. Appreciate it.

John Reed

Thanks Curtis.

Operator

Our next question is from Cristina Fernandez with Telsey Group.

Cristina Fernandez

Hi, good morning. I wanted to ask about the demand assumptions for the back half of the year. Dawn, you said you're assuming low single-digit to mid single-digit increases, which is really good in this environment, but a deceleration to what you've seen in the first half and so far in July. So, is it a function of the macro that's keeping you conservative or, I guess, maybe your thought process behind those assumptions relative to earlier in the year.

Dawn Phillipson

Yes. You know, Christina, it's just my own personal conservative nature. So, I feel we're executing. We're doing all the right things, we know that there's some things in the macro that we just can't control. So, I think we're trying to be mindful about the things we can't control, we're executing on the things we can. So, I don't want to get out of my skis on the financials in particular. So, I think that's a reasonable assumption. Honestly, we would be thrilled with that result.

So, that's where our heads are at.

Cristina Fernandez:

And then on the performance by channel, just looking at your Q in retail sales it seems like they were flat for the quarter, e-commerce up double-digits. So, anything to note? Are you seeing any divergence in demand trends by channel?

Dawn Phillipson

No. So, keep in mind that those are based off of delivered sales. So just as you're thinking about sometimes e-com has a higher EPS component than showroom sales. So it's just a timing metric. Nothing to call out, nothing to be derived from that. It's just a function of timing.

Cristina Fernandez:

And maybe one last clarification. On the delivery delays you saw this quarter because of the system upgrade, John, you mentioned that that will continue through the back half. Is it going to be the same magnitude of delays or is the impact going to be less as we move through the third and fourth quarter relative to what you saw in the second quarter?

Dawn Phillipson

So, as we're moving through this year, we're learning a lot. We've had a lot of change in the last two years from a systems perspective, from a supply chain perspective shifting from one distribution center to two. We never expected those to go smoothly, and true to form, there have been some kinks in the plan. So, we're learning a lot. We're figuring out how to implement and drive while continuing to execute. So, I think we feel really confident in the guide that we've put out there for this year, and we'll continue to drive to execute to that level, if not better.

Cristina Fernandez:

Thank you.

Dawn Phillipson

Thanks Cristina.

Operator

Ladies and gentlemen, we have reached the end of the question-and-answer session. I would like to turn the call back to Wendy Watson for closing remarks.

Wendy Watson

Thank you everybody for your participation in our call and interest in Arhaus. We look forward to speaking to you again next quarter.

Operator

Thank you. This concludes today's conference. Thank you for your participation. You may disconnect your lines at this time.