Arhaus Inc.

Fourth Quarter and Fiscal Year 2021 Earnings Conference Call

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Jonathan Matuszewski, *Jefferies*

Peter Keith, *Piper Sandler*

Jackie Sussman, *Morgan Stanley*

Steven Forbes, *Guggenheim Securities*

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Peter Benedict, *Robert W. Baird*

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PRESENTATION

Operator

Good morning, and welcome to the Arhaus Fourth Quarter 2021 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' Fourth Quarter and Full Year 2021 Earnings Call.

On with me today are John Reed, Co-Founder, Chairman and Chief Executive Officer, Jen Porter, Chief Marketing 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 the status of marketing initiatives, and Dawn will cover our financial performance and our outlook for 2022. After their formal remarks, we will open the call for questions. For Q&A, please limit to one question and one follow-up. If you have additional questions, you may return to the queue.

We issued our earnings press release and our 10-K for the year ended December 31, 2021 before market open today. These documents are available on our Investor Relations website at ir.arhaus.com. A replay of the call will also 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, as such factors may be updated from time to time in our other 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

All right, thank you. Good morning, everyone, and thank you for taking the time to join our Fourth Quarter and Full Year 2021 Earnings Call.

We are very pleased with our record fourth quarter and full year performance. For the full year of 2021, here are some facts: net revenue increased 57% to $797 million, with our retail channel up over 56% and our e-com channel up over 60%; comp growth increased 51%; net and comprehensive income increased 117%; adjusted net income increased 118%; and Adjusted EBITDA increased a notable 77%. We ended the year with 79 showrooms across 28 states.

Dawn will cover our fourth quarter and full year 2021 financial performance and outlook for 2022 in more detail later in the call, but we continue to be very encouraged by the trends of our business.

2021 was a monumental year for Arhaus. In addition to our record financial performance, we made some key investments that will support our long-term growth. First, we opened a nearly 500,000 square foot distribution center and upholstery production facility in North Carolina, we began our 230,000 square foot expansion of distribution and corporate offices here at home in Ohio, and we launched a new website to enhance our client experience and analytic capabilities. In addition, we transitioned to a public company with the initial public offering of our stock in early November.

Our results and accomplishments required a tremendous amount of work and execution by our over 1,700 associates. I want to personally thank them for all their hard work in growing Arhaus, as well as building our brand and being true to our mission and values, and delivering an incredible product and client service experience.

We have tremendous white space to grow our showroom footprints across the United States, and in 2021, we opened seven new showrooms, three traditional showrooms in Boca Raton, Florida, Salem, New Hampshire, Short Hills, New Jersey, as well as four Designs Studios in Burlingame, California, Princeton, New Jersey, Miramar Beach, Florida, and Aspen, Colorado. As part of our efforts to continuously optimize our retail footprint, we also relocated three showrooms in Oak Brook, Illinois, Charlotte, North Carolina and McLean, Virginia, and converted these showrooms to our new format, and closed two older format stores in redundant locations as their leases expired.

To update you on current supply chain dynamics and the expansion of our distribution and production capabilities, our inbound product supply chain is improving tremendously. Lead times continue to be a bit longer than historic averages, but we expect lead times to continue to improve throughout 2022. Further, we expect the recent and upcoming additions to our outbound capacity to help alleviate constraints over the course of 2022. Our new North Carolina upholstery production and distribution center is open, it's operating, and it's exceeding our expectations. The expansion of our Ohio distribution and corporate office facilities is progressing and we expect it to be operational later this year. We are extremely excited about a third distribution center in Texas, that we expect to open in the second half of 2022.

In closing, we have never been more excited about our business and the trends of our business. Demand remains strong across all channels and we are very focused on delivering our incredible product to our clients. We operate in a fast-growing, $60 billion premium home furnishings market in the United States. Our clients, who are predominantly from high-income households continue to invest in their homes and we continue to execute our growth strategy by opening showrooms and making the investments to build our brand awareness and grow our omnichannel footprint. With our market share today of less than 2% of this large fragmented market, we have a long and exciting runway for growth.

Now, I'll pass this over to Jen to review our current marketing initiatives in more detail.

Jennifer Porter

Thank you, John, and good morning, everyone. I am so happy to be able to share some of our marketing efforts from 2021 with you.

As a quick reminder, Arhaus is a 35-year-old heritage brand that offers unique artisan-crafted, heirloom-quality products to our clients. We are building out an omnichannel approach to marketing, anchored by our inspirational showrooms, and extending through our website, our catalogs and across digital channels and tools. We know what happens when a client sits on one of our sofas or sees the beauty and durability of a reclaimed wood table for themselves, so our priority is to bring the same experience to life across channels.

Digital continues to be an exciting area of opportunity for us. As John mentioned, our 2021 e-commerce revenue was up over 60%, compared to 2020. We saw critical digital enhancements with the launch of our 3D room planning tool, our shoppable digital catalogs, a virtual showroom tour, and a new email platform all in the first half of the year.

In December 2021, we launched our new arhaus.com experience, which I encourage you to check out. While still early days, the launch immediately stepped up our online client experience, by better showcasing our brand and allowing us to share more product knowledge. The site also bolsters our product merchandising and customer analytics capabilities. Our initial feedback and analytics are positive, with an increase in page views, time on site, as well as a reduction in cart abandonments, since the launch.

Earlier this month, we launched an omnichannel Outdoor Living campaign in support of our new and expanded Outdoor product collection. This campaign is a great example of the experience we can bring to life in our showrooms through our catalogs and online. Along with showcasing an exciting new product assortment, we are inviting our clients to journey with us to Greece and to get caught up in the magic of the Greek Isles. We believe that by being inspired by the world around us, we can help each client create their own personal oasis at home.

Print media is a critical piece of our omnichannel strategy. In addition to targeted mailings, we have two large catalogs each year, in January and September. On our last call, I mentioned the fantastic results we were seeing with our fall catalog. We are seeing this trend continue, with our January catalog sales significantly outperforming last year. Looking forward into 2022, we doubled the circulation of our Outdoor catalog, which hit homes earlier this month, as part of our Outdoor Living campaign.

Client growth was another highlight in 2021. New customer acquisition, both number of new clients and new client average order value, significantly increased over both 2020 and 2019. We achieved this growth across channels. Our seven new showrooms that opened in 2021 are a great source of new client acquisition for us. We also saw significant success in reaching new clients through our direct mail and social media channels. We continue to see strong results whenever we reach new mailboxes or partner with new influencers and media partners to share our story. Existing client numbers and value increased, as well, both in showrooms and online, driven by our targeted marketing initiatives and a great response to new product offerings.

Looking forward to 2022, our focus is on client acquisition, engagement and retention. We continue to learn and act on data from our new website launch and we'll share more details on upcoming enhancements in future calls. We have some really exciting campaigns and product launches planned for this year, as well as new showrooms planned for the second half of the year. As I mentioned earlier, we are thrilled with this month's launch of our Outdoor Living campaign and I encourage everyone to check it out when you have time. We look forward to sharing more information about our omnichannel development and growth throughout the year.

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

Dawn Phillipson

Thank you, Jen, and good morning, everyone.

As John mentioned, we are pleased with our 2021 fourth quarter and annual results, and the strong underlying trends in our business.

Please note that we have recast our financial statements to reflect an entity under common control with our operating company. The prior periods reflected in our Form 10-K have been adjusted to combine the entities for presentation purposes. The future impact to our financial statements is not expected to be material. For details and the recast financial information, please refer to our Form 10-K filed this morning.

For the fourth quarter, net revenue increased 46.3% to $238 million. The growth was driven by increased demand for our products in both showroom and e-commerce channels, as well as delivery of orders in the backlog as our supply chain continues to catch up with client demand.

Comparable growth was 40.5% in the quarter. Demand remained strong in the quarter, with demand comparable growth of 17.9% on a one-year basis and 79.8% on a two-year stacked basis.

Gross margin increased 39.1% to $97 million in the quarter, driven by our higher net revenue, partially offset by the related increase in product and transportation costs, as well as higher credit card fees and other store costs. Gross margin as a percent of net revenue decreased 210 basis points to 40.7%, better than our expectations, and reflecting higher product and transportation costs, partially offset by our ability to leverage our fixed showroom occupancy costs over higher net revenue.

SG&A expenses increased 57.5% to $100 million, primarily from investments to support the growth of our business, share-based compensation expense for equity awards, higher demand-driven commissions in our showrooms, and one-time costs related to the IPO. As a percentage of net revenue, SG&A expenses increased 290 basis points to 41.8%.

Interest expense was approximately $1 million.

Fourth quarter 2021 net income of $7 million includes a $12 million income tax benefit, primarily related to the recognition of a deferred tax asset that arose from our reorganization related to the IPO. This compared to net income of approximately $3 million in the fourth quarter last year. Adjusted net income in the fourth quarter of 2021 was $17 million. Adjusted EBITDA in the quarter increased 14% to $33 million, from $29 million in the fourth quarter of 2020.

For the full year, net revenue increased 57.1% to $797 million. Full year comparable growth was 51%. Demand was very strong throughout the year, with demand comp growth of 45.3% on a one-year basis and 70% on a two-year stacked basis. Gross margin increased 65.4% to $330 million for the year and gross margin as a percent of net revenue increased 210 basis points to 41.4%. Net income of $37 million for the full year 2021 was up 116.7%, compared to net income of approximately $17 million last year. This includes a $10 million income tax benefit, primarily related to the recognition of the deferred tax asset I just mentioned. Adjusted EBITDA increased 77% in 2021 to $123 million, from $69 million in 2020.

Turning to the balance sheet, as of December 31, cash and cash equivalents were $124 million and the Company had no long-term debt.

Net merchandise inventory was $208 million as of December 31, 2021, a 92.9% increase from December 31, 2020, as we built inventories in response to strong ongoing client demand. As I mentioned, while we are reducing our backlog and our comp growth is now outpacing our demand comp growth, demand remains strong and we continue to increase our inventory levels accordingly.

For the year ended December 31, 2021, net cash provided by operating activities was $146 million, and net cash used in investing activities was nearly $48 million, with landlord contributions of $18 million. As a result, total capital expenditures, net of landlord contributions, were approximately $30 million for the year.

Regarding our full year 2022 outlook, please refer to this morning's press release. Highlights include full year net revenue of $1.13 billion to $1.17 billion, full year comparable growth in the range of 35% to 45%, net income of $70 million to $80 million, and Adjusted EBITDA of $145 million to $155 million. We assume continued inflation and transportation, logistics, container and product costs, which we'll work to mitigate as needed. Regarding Adjusted EBITDA margins, we expect year-over-year margins to stabilize in the third quarter and expand in the fourth quarter. We expect healthy demand comp growth in 2022. As expected, we are seeing sequential declines for year-over-year growth. We will continue to ensure our inventory position supports our customer delivery time goals as we move through the year.

As John mentioned, we expect our new distribution capacity to help alleviate our backlog. So far in 2022, our North Carolina facility is outperforming our expectations and is positively impacting net revenue more quickly than anticipated.

Because of the timing of our fourth quarter and full year earnings release today, near the end of our first quarter, we're also providing insight into our first quarter expectations. We expect first quarter net revenue of $232 million to $236 million, net income of $12 million to $14 million, and Adjusted EBITDA of $24 million to $26 million. In future quarterly reports, we'll only be providing updates to our annual guidance. For all other details related to our 2022 outlook, please refer to our press release.

We're all pleased with the strong start to the year and feel well positioned to deliver on our financial and operational goals in 2022.

This concludes our prepared remarks, thank you for your attention, and we would now like to open the call up for questions.

Operator

Thank you. We will now be conducting a question-and-answer session. One moment, please, while we poll for your questions.

Our first questions come from the line of Curtis Nagle with Bank of America. Please proceed with your questions.

Curtis Nagle

Good morning. Thanks very much for taking the question. I'm curious, a little more detail on the outperformance. Really strong quarter, really nice guidance. It sounds like some of that is due to clearing the backlog is maybe a little better than expected. I guess, just what are you guys seeing from a customer or macro perspective? One of your bigger competitors have called out for potential headwinds and that was having an impact on near-term demand. Is that something you're seeing, or anything else we should be thinking about in terms of, yes, what is a really nice set of numbers for you guys?

John Reed

Yes, good morning. This is John Reed. Yes, we're seeing business pretty much as we had forecasted. Business is still strong, we've not seen a big drop-off, and we're marching forward here. Who knows what the future is going to bring, with everything going on, between inflation and wars, and so forth, but so far we've seen demand pretty much on track of where we had expected it. We've not seen a big drop-off.

Curtis Nagle

Okay, great, great to hear, and then maybe just a question for Dawn on the gross margins, that also came in much better than expected. I think you called out maybe some additional operating leverage on occupancy. Anything else that was driving the 200 bps better than, at least, we were thinking? So, yes, what are the big factors?

Dawn Phillipson

Good morning, Curtis.

Curtis Nagle

Good morning.

Dawn Phillipson

Sure. Container costs in the fourth quarter were not as elevated as we had anticipated, relative to our expectations. So, as you're thinking about your model, that's where there's some benefit in the fourth quarter. Apart from that, there was incremental leverage, as you would expect, on the higher revenue that is flowing through.

Curtis Nagle

Got it. Okay, very helpful, appreciate it.

Operator

Thank you. Our next questions come from the line of Jonathan Matuszewski with Jefferies. Please proceed with your questions.

Jonathan Matuszewski

Great, thanks so much for taking my questions, and nice quarter, guys. The first one was just on pricing. Other competitors in the market have been more aggressive with price increases. In 2021, I think you guys introduced a small increase early in the year and a larger increase later in the year. How are you guys thinking about pricing for 2022, is an increase contemplated? Any thoughts there would be helpful.

John Reed

Yes, we adjusted prices a couple times last year, as needed. We look at this very carefully. We are increasing prices as we're seeing our costs increasing, whether it's from vendors or from containers, which is, obviously, the two things that are increasing. But, it continues to be a lever for us. We're ready to pull the lever, as needed. If we see more price increases, we will take them. We don't see—we've done a lot of analysis on our products versus our competition. We're still extremely competitive, in many cases more competitive, and we'd like to stay more competitive, but if we have to take them, we will, and we don't see that being—going to affect our business, if we need to.

Jonathan Matuszewski

Great, that's helpful, and then my follow-up was just on supply chain. Last night, we heard from another executive that it's their view that supply chain hasn't gotten better at all, and I think you guys are painting a different tune this morning, in terms of suggesting that inbound supply chain logistics are improving tremendously and lead times are continuing to improve. So, maybe just help us kind of square those two kind of observations. What are you guys seeing from vendors in terms of new factories that they're building, expanded capacity that they're installing, and maybe greater allocation of resources to you guys? Any thoughts there would be helpful.

John Reed

Absolutely, yes, I can pitch in on this one. First of all, our business model, as I think we've explained to you guys, is a little different than a lot of our competition. Between United States, Mexico, Europe, it's a huge part of our business. United States is still over half of our business. So, we didn't have the big interruptions that—well, we had interruptions, of course, with the foam issue last year out of Texas, where nobody could make anything, any kind of domestic upholstery, but that's far behind us now. We don't have a lot of eggs in China's basket, which seems to be the holdup right now. China keeps shutting down. I think I just read they shut the entire city of Shanghai down for about a week or so here. We get things out of Asia, but it's more South Asia. Indonesia is one of our larger countries. But, again, we're getting things out of countries that have not been affected.

Now, with that said, with our business being so strong, all of our vendors have stepped up, they've increased their capacity. We're very happy to report that folks are shipping, for the most part, on time. It's taking longer to get here, of course. We factor all that in. So, we placed orders further out. We've already adjusted that. We've had plenty of time to figure that out last year. So, we're placing orders three or four months further out than we used to, but now that we're on that program, we're getting plenty of containers in, we're happy to report things are getting more and more in-stock every day, and it'll continue to be that way, because our goal and our concept is we try to keep everything in stock that customers see, so they can get it delivered right away, and that just continues to improve.

We just opened our new upholstery facility down in North Carolina, literally, last month. It's humming great. It hit what we wanted it to hit for March, as far as production goes, and we think we'll have plenty of capacity to take on more orders and to grow the business.

Jonathan Matuszewski

Excellent. Thanks for all the color. Best of luck.

John Reed

Thank you.

Operator

Thank you. Our next questions come from the line of Peter Keith with Piper Sandler. Please proceed with your questions.

Peter Keith

Hey, good morning, Arhaus team. Great results here. Maybe a quick question for Dawn. I know last year, when you were helping us shape the comp growth for 2022, you were always kind of assuming a mid-single-digit demand comp for the year. Is that generally what you're continuing to expect, and, maybe, would it be steady for the year, or do you think there's any change between the beginning of the year and end of year?

Dawn Phillipson

Sure. Good morning, Peter. So, while we don't guide to demand comps, what I can tell you is that we expected some sequential deceleration. So, a 17.9% demand comp in Q4, we have come down from that, which is what you'd expect. We can't continue to see these levels of increases year-over-year, wouldn't expect to. We are trending above the mid-single-digit for Q1 to date. We continue to be really pleased with the consumer response to our marketing, our product, our showrooms, so we think we're executing on all the right strategies.

Peter Keith

Okay, fantastic, and maybe I'll take that and pivot over to Jen. It just seems longer term you have this great brand awareness opportunity, so any data you can share? Maybe, I don't know if you would study it in the recent months, or just maybe how you saw brand awareness improve through 2021, it would be interesting to see.

Jennifer Porter

Yes, hi, Peter. We are really excited. We, obviously, pay very, very close attention to our customer numbers, so really looking at that new client to existing client split, and we're seeing that as the business has grown, really, the percentage of sales there, we're still seeing it hovering right around that 50% market, which we feel really, really great about that, considering how quickly the overall business is growing. We are seeing really strong results as we open up our new showrooms. As John mentioned, we opened up seven new showrooms last year, and we see those outperform the rest of chain in terms of new customer percentage, so definitely acting the way we would expect them to, as billboards for the brand, encouraging people to come in.

Then, I think one of the other areas that we look at very closely is things like organic traffic to the website, response to our catalogs, and we're doing prospecting, word-of-mouth elements along those lines, and we're really pleased with all of the data that we are seeing there. We're not reporting on the specific brand awareness metric that we spoke to in the IPO process, but all of the things that we are looking at, we're seeing our marketing methods check, and marketing methods check across the board, which really suggests to me that we are starting to gain traction in brand recognition. We're also …

Peter Keith

That sounds great.

Jennifer Porter

Yes, thank you.

Peter Keith

I don't want to interrupt, go ahead.

Jennifer Porter

Okay. No, I was just going to throw in a plug there for the new website, as well. I think just the engagement we are seeing on the website itself, not only is that, obviously, a media revenue driver, but the interaction, the time people are spending on the site, we're definitely seeing the brand resonate, which is another positive factor moving forward.

Peter Keith

Yes, that sounds great. Thanks so much, and good luck this year, guys.

Jennifer Porter

Thank you.

Operator

Thank you. Our next questions come from the line of Simeon Gutman with Morgan Stanley. Please proceed with your questions.

Jackie Sussman

Hi, this is Jackie Sussman on for Simeon. I was wondering if you could share anything in terms of the breakout of the comp in the fourth quarter between traffic and ticket, and anything about how the customer acquisition and traffic is both faring and trending quarter to date.

Dawn Phillipson

Sure. Good morning. Both transactions and ticket are up healthily year-over-year. AOV increased about 7% in the fourth quarter relative to prior year and number of transactions is up about 14% versus prior year. So, we're seeing healthy growth in both of those metrics.

Jackie Sussman

Awesome, thank you so much, and just a quick follow-up on the questions that have been there on demand comp. I guess, how are you guys thinking about backlogs and kind of when they will peak, how has that changed in terms of what your expectations were from last quarter, and is it embedded into the guide?

Dawn Phillipson

Sure. The demand comp would not include any backlog, that would be in our comp growth number, and we do expect—we did guide to a 35% to 45% comp growth for the year, that would include the backlog. As John mentioned, we're working diligently to bring the right inventory in at the right time to help clear through the backlog, and our lead times are expected to decline nicely by the end of the year.

Jackie Sussman

Awesome, thank you, guys, so much, and congrats on a great quarter.

Dawn Phillipson

Thank you.

Operator

Thank you. Our next questions come from the line of Steven Forbes with Guggenheim Securities. Please proceed with your questions.

Steven Forbes

Good morning. I wanted to start with the new store performance. John or Dawn, I'm curious if you could comment on the performance ramp of the '21 class of new stores relative to the expectations, or relative to the traditional sort of store model build, and then just provide us some insight on the current thoughts around 2022's class, and maybe inclusive of the new versus existing market outlook.

Dawn Phillipson

Good morning, Steve. We don't typically give guidance on—or performance metrics on specific showroom fleets, but what we will say is that we're pleased with the performance we're seeing. Showrooms are continuing to execute well and in line or above expectations on the demand side, so we're pleased with it. Jen mentioned earlier that customer metrics are doing well in those showrooms, so we think we're on target with our locations and our strategy for opening those showrooms.

Steven Forbes

Thank you, and then maybe just a quick follow-up, maybe, John, for you. As you think about the opportunity here in 2022, given the brand awareness ramp that has transpired and all the work that you guys have sorted executed on, what do you sort of view as the category or the greatest opportunity, the Outdoor launch? Is there any sort of framework you can help us sort of contextualize as you think about where Arhaus is really leaning into in terms of a category perspective, or just driving the value proposition to a broader customer demographic?

John Reed

Sure. We took the strategy a year—when COVID started that we were going to continue working on new products in all categories, increasing our selection, offering more exciting products, even upscaling some of the products, and the team has done a great job with that. One thing we did that we think is a little different than some of our competitors is we've been aggressively rolling out new products. The last January catalog, that just hit a couple of months ago, had, I don't know, over 200 new products in it, I think we had advertised. The new Outdoor catalog that we just had, just last week, was just game-changing for Outdoor, we think. It was photographed over in Greece. We think it's the best-looking Outdoor catalog anybody has done in the business. So, we're excited about that category, as well, but really excited about all the categories.

We've got a great team of really talented folks that have been coming out with some great new products, and we've been aggressively doing that, because we think—we look at times like this, when people do cut back, they don't introduce new things, they don't produce as many catalogs, and so forth, and we kind of took the opposite approach, and it seems to be working for us.

Steven Forbes

Thank you.

Operator

Thank you. Our next questions come from the line of Adrienne Yih with Barclays. Please proceed with your questions.

Adrienne Yih

Good morning, everyone. Congratulations on the fourth quarter and then the success on trending into the first of the year. My first question is on digital—I'm sorry if I missed this, but did you actually give digital percent sales penetration, and, Dawn, can you give us some color on the EBIT segment margins there relative to the four-wall of the stores? Then, my follow-up is, in terms of inventory, you talked about the lead times getting better, so, to the extent that can you give us some color on the component that is in-transit and what that inventory is in units at the end of the quarter? Thank you very much.

Dawn Phillipson

Good morning, Adrienne. For the full year, e-com penetration was right around 18%, in line with our expectations, and we're pleased with the performance of both segments in e-com and showroom. As we think about inventory, it's important to keep in mind that we use a landed cost, and so, as those container costs are increasing, the inventory levels are increasing. I think that's just important to note, as we think about this year and then go forward.

Apologies, what was the other portion of your question, Adrienne?

Adrienne Yih

Yes, it was basically in terms of the breakdown between kind of what's in-transit and then the difference between the actual dollar costed inventory versus units? So, what's the spread, is it 10%, is it 5%? Basically, cost of inflation is, effectively, the crux of the question.

Dawn Phillipson

Yes, we don't typically give units, just given that there is kind of a lot of volatility as you think about sofas versus décor, so I'm not sure that that metric would be terribly helpful for you. As we think about in-transit, there is a decent amount of inventory in-transit. If you think about how we invoice and pay for our inventory, we typically take possession of that inventory at the foreign port and then bring it in. So, as you think about international transportation, or international inventory being 50%, you could probably take a—gosh, Adrienne, you're asking a good question here. I don't know if we can give the number. I mean, it's—I wouldn't say it's a meaningful amount. It takes about 20 days for product to get, internationally, here, in the event that that's helpful to you.

Adrienne Yih

Yes, we can back into it. Then, my final question is, on the basis point impact to gross margin in the fourth quarter—and I know you had some in the third quarter—when you're giving your guidance for 2022, everything seems to be getting on a track to improving. Are you expecting embedding in that guidance a reversal, like, a net (inaudible) in 3Q and 4Q in that guidance on the GM line?

Dawn Phillipson

Yes, not yet. We've seen container costs stabilize the end of the fourth quarter, first quarter, and that, you saw, is driving some gross margin benefit in the fourth quarter. As we think about the number of containers that we're bringing in this year that would have container costs applicable to it, and the percentage that we've managed to secure on a contract rate versus a spot rate, I'm not comfortable taking those container costs down yet. I just think it's not prudent. There's other things that are factoring into that gross margin rate, as well, in 2022. Things like fuel surcharges that we're seeing on the outbound side, transportation from the DCs to the hubs and the client homes, that's also factored into the 2022 guidance. You know, we want to be prudent, we want to forecast in a responsible way, so as of yet, I don't think it's the right time to take those container costs down for the balance of year.

Adrienne Yih

Yes, that's prudent. Thank you very much and best of luck.

Dawn Phillipson

Thank you.

Operator

Thank you. Our next questions come from the line of Peter Benedict with Baird. Please proceed with your questions.

Peter Benedict

Hi, good morning, everybody. A couple questions. First, just on the backlog, still considerable, over 40%, I think, of your (inaudible) revenue. Just, I'm curious on how you're planning for that to flow into the P&L and into revenue across '22, any color on first quarter or first half, second half. Then, I'm trying to understand, maybe, what's normal for the business. You guys, obviously, have a plan here. Where might that backlog be at the end of this year if you kind of just do the numbers that you've laid out, any help on that? That's my first question.

Dawn Phillipson

Sure. As we think about delivering the backlog, one of the constraints we have is our capacity to ship out of our facilities that we currently have. Boston Heights, we have this one facility, and have had it. North Carolina, we opened up on the shipping side the end of Q4. That is outperforming expectations, which we're really pleased about. But, as you think about deliveries, once we get our Dallas, Texas facility open in the third quarter of this year, we'll see a nice uptick in those delivered sales in the revenue line. Capacity constraint on our side, on the outbound side, certainly is one of the items that's inhibiting catching up on that backlog, so we're excited for Dallas to open, and it's on track, so we're pretty thrilled about that.

Peter Benedict

That's helpful, and any perspective on what's normal? I mean, I know you guys are doing a lot here on the distribution side, and so maybe your experience two/three years ago is not informing, maybe, what is possible here from a backlog perspective. Again, it's north of 40% of revenue, your trailing revenue. Is there a framework you can help us think about when, maybe, the business is "back to normal," where that might be landing? If not, no problem, but just curious.

Dawn Phillipson

Sure. In the transaction, we had noted that the growth rate for 2022 and 2023 would be right around 30% net revenue, with '22 being a bit higher, '23 being a bit lower, and then we would normalize as we move into '24, and beyond. So, we do think there will still be some backlog to deliver. It is a rolling backlog, so clients are not waiting. We wouldn't expect them to be waiting, you know, that length of time. But, as far as a backlog number for the end of this year, we're going to push through as much of it as we can. It's the right thing for the client, it's the right thing for the Company. So, more to come on that, I guess, as we move through the year, but it's a bit early to speculate on that at this point.

Peter Benedict

No, fair enough, and thank you for that, and then my next question, maybe for Jen. You talked about '22 being kind of a year of customer acquisition and retention. Maybe help us with what you think are some of the most impactful marketing initiatives you have on tap for this year, and maybe some perspective around the cost to acquire customers, how that's been trending, and what kind of your view is on that going forward. Thank you.

Jennifer Porter

Yes, of course. Good morning. I think we have a lot in the works. I think what's really exciting about Arhaus is that we have this brand, this story, this artisanal product that's been developed for 35-plus years, and we're really focusing on now introducing that story to more people, so we have a really broad mix of marketing tactics and levers that we can pull. As I mentioned on the call, and as John reiterated, we are absolutely thrilled with Outdoor, and I think that's really showing a step-up in what we can do in terms of getting that story out to more consumers, not only through our showrooms, but also digitally on the site, through our direct mail, through partnerships with media and influencers, and then there's other things that you'll see throughout the year.

I think I am really excited about some of our upcoming big launches. Looking at fall, we'll be launching our next big catalog and more new product surrounding that. So, we have a lot of actions and activities surrounding that element.

This month, actually, at the beginning of the month, we just celebrated the opening of our Aspen store in Aspen with an event in that market, and I think that was a really great example of how we market and address specific communities. We are really excited when we open up a new showroom, to be joining a community and meeting our neighbors, and really being able to introduce the brand one-on-one to potential clients. I think that event and that initiative in that local market, while it was local to Aspen, it has legs nationwide, and was really powerful to get to know that climate, and so I would expect to see more initiatives and actions like that.

Moving to your question about customer acquisition and costs, I'm sure you're hearing this across the industry, digital marketing is an ever-evolving arena. With all of the privacy regulations and things that have come up, costs are going up, and so we are seeing costs rising. We're seeing efficacy of some of our campaigns falling. I think, though, again, what we are really pleased about is that we do have that broad marketing mix. We do have new showrooms opening. We do have a very, very strong print marketing program. We are really just in the early stages of working with influencers and partners outside of our brand. Then, we have an incredibly strong team that we have really worked very hard to bring in-house over the last few years. So, we have people focused on every campaign and initiative that we are doing, constantly optimizing and re-evaluating our spend on any specific channels, and we're not committed to any one channel to achieve our business needs, we can sort of shift the funds around and move things, as we need to continuing working.

So, we're feeling really excited about 2022. Obviously, we'll be paying very close attention to the market and everything that's going on there, but a lot of fun things to come, which I look forward to telling you about later in the year.

Peter Benedict

That's great, super-helpful. Thanks very much.

Operator

Thank you. Our next questions come from the line of Cristina Fernández with Telsey Advisory Group. Please proceed with your questions.

Cristina Fernández

Hi, good morning. I had a question for John. Following on the supply chain comment around the lead times coming down, would you be able to give some color of where are they, maybe, on weeks versus peak, and how is that translating to the order wait times your quoting customers, have those been able to come down, and how are they trending versus key competitors?

John Reed

Good morning, Cristina. Yes, they have definitely come down, they're way off the peak, and I think we're quoting eight/nine weeks now for our customers to wait, on average, which before had been 16, 25, and so forth, last year. So, they continue to come down, and every month they're coming down less and less. Our upholstery business, which is a big, big part of our business, the custom part, which is what we're really known for, has come down over a month. The lead times have gotten shortened by a month last month, and I think next month, we're going to shorten it by another month, so it continues to come down. Customers are responding very nicely to the decreases, because they'd rather not wait, they like to get their product. So, we've been doing a nice job right across the board with lead times coming down, certainly on our best sellers, as well, which is very important, of course.

We track what competitors are doing, they're all over the board. Some are still out 20-some weeks on things, some are trying to get things in stock. Again, it depends on where they're getting them from, and so forth. But it's, literally, all over the board right now.

Cristina Fernández

That is very helpful, and then my second question, I wanted to ask about the interior designers, which is a key initiative for the Company, and enable to get more AOV. How did that trend in the fourth quarter as far as penetration, are you seeing that increase, and so your thoughts about expanding the interior designer community in 2022?

John Reed

Right. We have our own internal designers, as well as we work a lot with the trade, and both have been growing very, very nicely last year, and the trends seem to be continuing for this first quarter. We're thrilled with that business and we're going to continue to grow it. We've got initiatives in place to grow both internal designers and outside trade designers.

Cristina Fernández

Thank you, and …

John Reed

Oh, right. Sorry, she was a writing a number down for me. Yes, we have over 70 designers currently on staff, and we're looking to grow that.

Cristina Fernández

Okay. Any color you can share on the penetration of, I guess, your percentage of sales that are coming from those interior designers?

Dawn Phillipson

Yes, hi, Cristina. Demand penetration continues to increase with those designers, so we're finding that the program is really resonating, and we're pleased with the performance, but it's up nicely versus last year.

Cristina Fernández

Thanks again.

Operator

Thank you. There are no further questions at this time. I would like to turn the call back over to Wendy Watson for any closing comments.

Wendy Watson

Thank you, everyone, for participating, and we look forward to talking to you again next quarter.

John Reed

Thanks, everybody, appreciate your time. Have a great day.

Operator

This does conclude today's teleconference. We appreciate your participation. You may disconnect your lines at this time. Enjoy the rest of your day.