VIAVID communications simplified.

Arhaus, Inc.

First Quarter 2023 Earnings Conference Call

May 4, 2023

CORPORATE PARTICIPANTS

Wendy Watson, *Senior Vice President, Investor Relations*

John Reed, *Co-Founder, Chairman, and Chief Executive Officer*

Dawn Phillipson, *Chief Financial Officer*

Jen Porter, *Chief Marketing Officer*

CONFERENCE CALL PARTICIPANTS

Julio Marquez, *Guggenheim Partners*

Peter Benedict, *Robert W. Baird*

Peter Keith, *Piper Sandler*

Jonathan Matuszewski, *Jefferies*

Seth Sigman, *Barclays*

Simeon Gutman, *Morgan Stanley*

Cristina Fernandez, *Telsey Advisory Group*

Phillip Blee, *William Blair*

Max Rakhlenko, *TD Cowen*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Arhaus' First Quarter 2023 Earnings Conference Call.

At this time, all participants are in 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 hand the call over to your host Wendy Watson, Senior Vice President of Investor Relations.

Wendy Watson

Good morning and thank you for joining Arhaus' First Quarter 2023 Earnings Call.

On with me today are John Reed, Co-Founder, Chairman and Chief Executive 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. Dawn will cover our financial performance and outlook for the remainder of 2023, and then they will be joined by Jen Porter, our Chief Marketing Officer, for the Q&A session. 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 March 31, 2023, before market opened 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-Qs, 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 revise or update 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

Good morning everyone, and thank you for joining us today. I will keep my comments today brief, providing a few highlights on our first quarter performance.

We are very pleased with our first quarter 2023 results, delivering net revenue of $305 million, a 24% increase over Q1 last year, comp growth of 21.0%, an increase in net and comprehensive income of 112%, and an Adjusted EBITDA increase of 76%. Demand comp growth in the first quarter was 5.6% with March sequentially decelerating to a flat demand comp following high-single-digit demand comps in January and February. In April, our demand comp remained flat.

As we discussed with you when we reported last quarter, our focus in 2023 is investing in our long-term growth and showrooms and systems that will fuel that growth, while at the same time continuing to prioritize product, building brand awareness and putting our clients first.

In the first quarter, the key performance drivers include our product assortment and our marketing campaigns. From a marketing perspective, we are very pleased with our current campaigns, and we are excited for our plans throughout 2023, including some great new partnerships and the support and emphasis we place on marketing our new showroom openings.

Speaking of our growing showroom footprint, I am pleased to update you on the progress toward opening 12 new showrooms this year. We opened new one, a Design Studio in Asheville, North Carolina on March 10th and in Naperville, Illinois on April 14 as well. In June, we expect to open a new showroom in Topanga, California, and a new Loft location in the Dallas area, with the remainder of our eight additional expected new showroom openings in the second half of the year.

Our renovation, relocation and expansion projects are all proceeding as expected, and we are very excited about the new relocation showroom we just opened last week in Towson, Maryland.

Moving to supply chain, as we are well positioned on both the inbound and outbound elements of the supply chain, and in most cases our product lead times are back to pre-pandemic levels, our expanded distribution footprint, along with the systems capabilities we are implementing will support our growth for the next seven to ten years. One example of these capabilities enhancements is our warehouse management system we began implementing last month, which will enable us to move product through our supply chain more efficiently.

To share further operational details, I am very excited about the past two days I just spent at our upholstery production facility in North Carolina. The facility combines state of the art production machinery and tools with skilled upholsterers crafting the best upholstered pieces available anywhere in the world. I was at the facility with our product development and regional sales team leaders and I am impressed and inspired by the enthusiasm of these incredibly talented teams, coming together to brainstorm and work on future collections that we believe our clients will love.

Turning to our outlook, as we announced this morning, given our solid first quarter 2023 performance we are reaffirming our full-year outlook and Dawn will share these details with you.

In summary, I want to reiterate how pleased we are with the start to 2023, the client reception we have seen to our new products and the progress we continue to make with new showroom growth. As we look to the future, we remain confident in our strategy, with a balance sheet that is well-positioned to navigate any macro choppiness, and focused on delivering long-term growth and shareholder value.

Finally, I want to thank our team for continuing to focus on our clients first. It is truly astonishing to me how you have pulled together over the past few years of tremendous growth. Between 2019 and 2022, our net revenue grew 149%, our net income grew 762%, and our Adjusted EBITDA grew 346%. In just this first quarter of 2023, our net income and Adjusted EBITDA surpassed all of 2019's net income and Adjusted EBITDA. This is a testament to your commitment, and I am incredibly proud of all of you.

Now I'll turn it over to Dawn.

Dawn Phillipson

Thank you and good morning.

As John described, our business continues to be resilient and we are pleased with our operational and financial performance in the first quarter.

Key items from our first quarter 2023 income statement include net revenue of $305 million, comp growth of 21%; and demand comp growth of 5.6% on a one-year basis, 13.9% on a two-year stacked basis, 104.2% on a three-year stacked basis, and 101.7% on a four-year stacked basis. We thought a four-year stack could be helpful to compare to demand pre-pandemic.

During the quarter, we saw strong revenue growth in both our Showroom and eCommerce sales channels with our Showroom channel up 23% and our eCommerce channel up 25%. Our net revenue growth was driven by both demand and the continued delivery of orders in our backlog.

Our first quarter gross margin increased 31% to $128 million in the quarter, driven by our higher net revenue, partially offset by higher variable costs related to the increase in net revenue, including product, transportation, and variable rent expense, as well as 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 240 basis points to 42%, primarily reflecting favorable product costs and our ability to leverage our fixed showroom occupancy costs over the higher net revenue, partially offset by higher variable showroom costs and transportation expense.

First quarter SG&A expense increased 11% to $83 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 demand, partially offset by lower product storage fees as we have expanded our warehouse capacity and delivered more of our backlog.

SG&A expense as a percentage of net revenue decreased by 320 basis points to 27%, primarily driven by leverage on fixed costs on the 24% net revenue increase.

First quarter 2023 net income increased 112% to $34 million. Adjusted net income in the first quarter of 2023 increased 101% to $34 million compared to adjusted net income of $17 million in the first quarter of 2022, primarily driven by the factors just described.

Adjusted EBITDA in the quarter increased 76% to $55 million from $31 million in the first quarter of 2022.

First quarter 2023 net revenue of $305 million and Adjusted EBITDA of $55 million resulted in an 18% Adjusted EBITDA margin in the quarter, an increase of 530 basis points year-over-year.

Turning to the balance sheet and cash flow, as of March 31, 2023, cash and cash equivalents were $145 million, and the Company had no long-term debt. Net merchandise inventory was $292 million, up 2% from December 31, 2022, and up 18% year-over-year, as we continue to build inventory in response to client demand and as inventory value has increased due to higher freight and product costs. Client deposits decreased to $198 million, down $5 million from December 31, 2022, and down $108 million year-over-year, primarily due to the improved delivery of orders in backlog and lower demand comp growth relative to prior periods.

For the three months ended March 31, 2023, net cash provided by operating activities was $8 million and net cash used in investing activities was $8 million, with landlord contributions of $1 million. As a result, total capital expenditures net of landlord contributions were approximately $8 million in the first three months of 2023.

Let's move now to our outlook. As we announced this morning, we are reaffirming our full year outlook for 2023. We continue to expect full year net revenue of $1.24 billion to $1.3 billion, representing growth in the range of 1% to 6%; full year comparable growth in the range of negative 4% to positive 1%; net income of $95 million to $110 million; and Adjusted EBITDA of $180 million to $195 million.

Our outlook reflects the expectations that we will continue delivering our backlog through 2023, achieve a demand comp range of negative 1% to up mid-single digits, and carefully manage our expenses even as we continue to invest in growth, including new showrooms, marketing, product development and investments to enhance omnichannel and technology capabilities, including information technology and systems infrastructure, all of which are expected to accelerate brand awareness, support growth and generate efficiencies from scale.

We remain confident in our full year guidance, understanding there may be some variations in our original first half and second half assumptions. For example, first half net revenue may be up low teens versus the high teens we originally expected based on the cadence of delivery and demand trends. And, given Q1 EBITDA margin performance, first half EBITDA margins could be up greater than the 100 basis points we initially guided to. But overall, we see nothing today that causes us to modify our previously issued outlook for the year.

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

In closing, we are pleased with our first quarter performance and, despite an ever-changing macro environment, 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. Ladies and gentlemen, we will now be conducting the question-and-answer session.

(Operator instructions).

Our first question comes from Steven Forbes of Guggenheim.

Julio Marquez

Hi. This is Julio Marquez on for Steven Forbes. Thanks for taking our question. I wanted to ask a question around the product lineup. How are customers engaging with the product, just kind of given the environment. Then very quickly, touch on the real estate pipeline. It's our understanding that a large number of Showroom projects in your history, and just given the market out there for real estate, what you're seeing even from landlords, any incremental negotiating leverage? If you could please touch on and give us an update on what those preopening costs are looking like, that would be great. Thank you.

John Reed

Sure. Good questions, Steven. Good morning.

The answer to your question on the product, response has been phenomenal. We've launched we think some very creative, very exciting products that our clients are really, really responding to. It's not only well designed, things that no one has ever seen anywhere else, literally, in the world. It's a great value for what it is. The really hot stuff is really more handmade things, very unique things, that people are responding to. We're thrilled with our new launches and we see them continuing throughout the year as we expand into more SKUs, more sizes, more categories of similar looks of some of this product.

As far as landlords go, yes, as you know we do have the largest opening, store openings ever. Those deals were done mostly during COVID when landlords were a little anxious on their showrooms, so we feel we've got a great value going. These are A+ locations. Their centers tend to be 100% filled. It's not like they're struggling to look for tenants. I still believe the retail locations are key to our business and to our growth, but we're really focusing on great locations.

Some of the rents aren't as cheap as going to B or C locations, but you get our traffic of our clients; they live in there and they visit it many times a month, and it's working for us. We're happy with everything from how we negotiated the leases, what we're paying—we think it's very, very fair—and like I said, most of those were done during COVID because you need to be at least two years out on getting new stores open at a minimum.

Julio Marquez

Great. Thank you. Just very quickly, just on preopening expenses and just startup costs for new stores, any color you could provide on that would be great. Thank you.

Dawn Phillipson

Good morning. This is Dawn.

We haven't disclosed what the preopening costs are but we did say there would be a drag in the second half a bit, just as we're thinking about the length of time it takes to open a new Showroom and when that rent starts to be incurred on the P&L, so there is some compression in the back half related to the new Showrooms that we are opening next year as well as this year.

John Reed

And as a far as cost, obviously as we all know everything went up in price. Labor, materials, light fixtures, wood, everything has really gotten much more stable though, we've found, this year, so we know what our costs are, in other words. No surprises at all. Our construction guys are hitting deadlines. We see no delays right now that we can foresee in anything. All the pieces and parts are coming together, but certainly, yes, things cost more than they did three years ago, for sure. As everything did—does, I should say, in this world right now. But we've already factored all that in and that's all part of the plan.

Julio Marquez

Awesome. Thank you.

John Reed

You bet.

Operator

Thank you. The next question comes from the line of Peter Benedict of Baird.

Peter Benedict

Hi, you guys. Good morning. First question, just on the first half low teens versus the prior high teens view, just maybe talk a little bit more about that. How much of that is the demand environment you're seeing? How much is maybe backlog fill sliding into the second half? As you think about the second half, are you still thinking down high single digits, or does that benefit from this shift, or should we be thinking kind of lower end of the revenue plan is probably more likely at this point? That's my first question.

Dawn Phillipson

Morning, Peter. The first half, we expect some of the backlog to push into the second half. Really, it's dependent upon a variety of factors including a lot of clients are continuing to build and remodel and are not quite ready to take the product into their home yet. Then, we've also seen a really nice acceleration in the number of large orders that we've had over the last few years, and so some of those clients, while we may have the majority of pieces for that order, we're waiting on one piece. So in order to be as efficient with the client as possible, we're waiting for that one piece to be receipted in and then we can deliver it to their home. So, those are a couple of the larger reasons that it will cause some of that backlog to push into the second half.

Peter Benedict

Okay, thanks. Then just on the demand being flattish at this point, can you talk a little bit about, I don't know, if there's a regional tone to that shifting down. I mean, obviously it's been expected that you're going to see your demand moderate, but just any color on what you're seeing around demand would be helpful. Thank you.

Dawn Phillipson

We haven't seen anything too meaningful from a regional perspective. I will say there was a little bit of noise perhaps in the California markets in March in particular. John or Jen, do you want to—any color on …?

John Reed

Well, a big part of that was weather. They were getting those huge, huge rainstorms and I think that slowed a little bit down. But yes, we haven't seen anything—normally the Midwest is a little more cautious in times of uncertainty than the rest of the markets, but it's a very small, very small percent.

Being 149% up over the last few years, being flattish we're pretty excited about that. Like I said, we're getting set to getting all these new stores in place, getting this new product in place. We're renovating quite a few stores on top of the 12 we're opening. We're really setting ourselves up for a great position that when people really start booming and the economy starts booming again, we're set to capture our share of that market.

Peter Benedict

That's helpful. I guess my follow-up would just be on inventory. Up 18% year-over-year, you're adding stores, clearly. Just talk a little bit about the complexion of the inventory, how you feel about it, what your plans are for the balance of the year in terms of adding inventory. In the event that demand continues to moderate or moderates further than you expect, your kind of promotional plans for the year, how you're thinking about your marketing approach. Thank you so much.

Dawn Phillipson

Sure. I'll start with the promotional cadence. We feel confident in our product assortment offerings and how we have positioned ourselves from a price perspective. That being said, we certainly have promotions as a lever if we choose to deploy those. We chose not to in March and April and still came in quite nicely, flat comp, so feel good about where we're positioned. Recognize that we have some dry powder if we choose to exercise that.

From an inventory perspective, our lead times are coming down relative to where they were before, certainly at the height of the pandemic, so that provides us a little bit more flexibility as we're looking out into the next six, 12 months. We are very vigilant with our inventory. We're paying close attention and analyzing where we're at, at a very detailed level. A significant amount of our inventory still is at that higher freight cost rate as well, so keeping that in mind as that's going to flow through the P&L this year.

We did bring on a new SVP of Planning about six months ago who has been really helpful in helping us to understand and kind of engage with vendors and analyze our inventory position. I think we've mentioned this in prior calls, we're also looking to deploy some planning software that's really going to help our team to be able to just be a little bit more efficient and effective with the inventory planning over the coming months.

More to come on that, but at this point in time we don't see any inventory issues that would cause us to have significant margin degradation for the year.

Peter Benedict

Thanks so much. Good luck.

Dawn Phillipson

Thank you.

Operator

The next question comes from the line of Peter Keith of Piper Sandler.

Peter Keith

Hi. Thanks. Good morning everyone. Maybe just to follow-up a little on the last question with promotions and the like. You did call out lower product costs as a key driver to the nice gross margin expansion. I'm wondering if you could unpack that a little bit more. Are you holding price and then your suppliers are lowering price? Is that just a one quarter benefit, or is that something that has potential to continue as the year progresses?

John Reed

I can start that, Peter. Good morning, by the way.

I think a lot of the cost we're seeing is really in the freight. The freight costs have come down so much from last year. Granted, we still own some inventory at that freight cost, but obviously every day we're delivering that and then any of the new product that's coming in is at the lower freight cost.

As far as our vendors go, we've seen a little bit of decrease in price, but the good thing is we haven't seen anybody increasing prices, certainly this year, so we've held very steady with that. We're constantly out negotiating as some of our new products surprise us, and we're selling even more than we'd even thought. The manufacturers get a little more efficiency as they make a little bit more at a time and they're certainly passing those savings on to us. But it's not a huge amount.

We see throughout the year as we sell down on this inventory that we paid so much in freight, that certainly is going to help the margin.

Peter Keith

Okay. That's very helpful.

Dawn Phillipson

Peter, just to add in a little bit, the 2 percentage point favorability versus last year on product COGS, that's really a combination of freight, product mix, and then also keep in mind that with the North Carolina facility really ramping up, our cost is at a landed cost, so as we think about all the upholstery that prior (inaudible) incurred cost to come up to Ohio, it's now basically just going kind of across the street, down the street. So, there's also some favorability from that.

As we move through the year, we would expect to continue to see favorability from the upholstery facility, product mix. Freight, it's really going to be contingent upon the product mix that is being delivered and the timing of when we receipted that in. So, we do have a substantial amount of inventory at above 20% freight cost as a percent of inventory, so just to give a little bit added context there.

Peter Keith

Okay. All right. That's helpful and encouraging. Maybe, Dawn, I'll stick with the next question to you.

I was just jotting down notes that you were laying out with the guidance. I think on the demand comp, if I'm not mistaken, you say that you expect the full year to be down 1 to up mid single digit?

Dawn Phillipson

That's correct.

Peter Keith

So, just thinking about Q1 was good, a little bit slowdown, I guess it does imply some reacceleration as the year progresses. Can you just give us a sense is that—are we thinking about stack trends and holding stack trends? Do you have some initiatives you think can reaccelerate the demand? Just maybe get us a little bit more comfortable with the potential improvement in the months to come.

Dawn Phillipson

We have a lot of exciting marketing initiatives, which I'll hand over to Jen. We're investing more this year in additional touchpoints and excited for that. I mentioned we have some dry powder with promos if we need them or if we choose to exercise those. But, you know, the first quarter was mid single digits, so up really nicely. We think there are some things that occurred specific to probably March and April that kind of pulled down the comp load a bit, but still we're really pleased with that first quarter comp. I mean, mid single digits is great.

Jen, do you want to talk about some of your marketing you have for this year?

Jen Porter

Yes, sure. Hi. Good morning.

As Dawn said, we're really excited by the responses we've seen to our marketing so far this year, and then also what we have planned for the rest of the year. Touched on a few things on prior calls about being a little bit more aggressive and going out after some new client acquisition and prospecting, particularly through our direct mail campaigns. We're really pleased with the results we saw for those, both for January campaign, which hit homes at the end of December, and then also our March outdoor campaign that hit homes in the beginning of March. Our summer campaign just hit homes end of last week, beginning of this week, so really anxiously looking forward to seeing the results off of that as well.

But really, really pleased, particularly with the response from that new client acquisition. As John mentioned earlier, we're really seeing incredibly strong response from clients as they get introduced to the brand. People are responding to the storytelling; they're responding to the quality of our product. They're responding to the artisan craftsmanship, how unique the product is, and we're really, really encouraged by that looking forward.

I think in terms of other marketing initiatives, we continue to be really optimistic about what we're seeing in the digital space. As I've mentioned on prior calls, and I think everybody in the industry mentioned their digital marketing has been tough over the last few years. Costs are going up. Having to pay really close attention to campaigns, but we have an incredible team in-house who have incredible relationships with the various players in the markets, and really happy with the performance that we're seeing. The teams are managing those campaigns on a daily basis to really optimize the performance.

We're really getting cautiously optimistic and excited about some new campaigns and initiatives and tactics that are coming down the path as well, just as we think about getting our story and our product in front of the right people at the right time in their journey. When we get them on the site too, we're seeing really good engagement there, so I think great traffic to site and great sales on the site, but also really excited by the length of time people are spending exploring product.

As you know, we've really been investing in the Arhaus.com experience and the digital experience as a whole, really as a lever and a channel and a way to connect with customers for that omnichannel experience. We see the majority of our clients are engaging with us digitally regardless of where they are purchasing. So, we really see that as an investment and an opportunity to continue to bring clients into and convert sales both online and in stores.

In terms of experiences, last year we were really excited to launch our partnership with Surf Lodge in Montauk. We were really pleased with how that came about and how the summer turned out. Some really fun, exciting opportunities to get our product literally in front of new prospective clients, people sitting on them, engaging with our product. So, we're really excited to continue that partnership this year.

Then, we've also partnered with The White Elephant in Nantucket. The White Elephant Hotel is an iconic property in Nantucket. They're actually celebrating their 100-year anniversary this year and have done an incredible renovation and refurbishment of the space, and we'll be positioning our outdoor product around their property. Starting Memorial Day, clients will really be able to experience that. A really cool assortment inspired by Nantucket. Some of our great teak New England collections, and we were able to partner with them to custom create some cushions in the iconic White Elephant blue fabric as well, and a great performance fabric.

So, really excited about that. Obviously Nantucket is beautiful, but looking forward to being able to share more details about that on future calls.

We've also really been exploring and building out our partnerships with influencers, with designers, with personalities, partnering with trade. Just really a lot of great things coming down the pipeline this year.

Then, I think it's important too just to stress how excited we are about the new store openings. As we've mentioned, with our brand awareness new stores continue to be the number one driver of new brands.

Awareness within clients, people see the showrooms, they get drawn into the showrooms, they get to engage with the product.

Number two is recommendations from friends and family. As we see all of these new stores being opened, they're just such a great way for us to engage with new clients, with existing clients who maybe have a second home near a store or have recently relocated, or maybe engaged with us digitally and now get to experience us in a store. We're really going to be investing a lot of time and attention in supporting those openings back half of this year as well, and excited to see the results there.

John Reed

I just wanted to add one thing to that. Our clients buy from us and the number one request we get from our sales team and designers out in the stores is our clients just love the story of how our product, how it came about, how it's made, so we're doubling down on that. We just did a—Jen and her team just did an amazing not only small catalog but also a digital video on going into our factories and literally showing our clients exactly how things are made, how they are created, how they're designed. We think that inspiration—because that's why clients buy from us. They are inspired by our product. They just think it's so unique, not to mention unbelievably practical and comfortable and everything else that you need in furniture. So we're really doubling down on that and showing the emotional side of our product, which is why people buy us. Everybody could go to Ikea and buy things; they're cheaper than us, but our product is so unique and special that clients love it. They love to bring it in their home and they love the stories about, 'Do you know how this table is made? It takes this long and this kind of material,' and so forth. When they see that, they get inspired and they buy more product.

Jen and her team have come up with some really cool catalogs and videos that we're going to be pushing out to our clients for the rest of the year.

Peter Keith

All right. Great. There's a lot of good content in that answer, so I appreciate it very much. Thank you.

John Reed

You bet.

Operator

The next question comes from the line of Seth Sigman of Barclays.

Seth Sigman

Hey everybody, good morning. Thanks for taking my question. I was hoping you could provide a little bit more context on the moderation in demand comps that you saw in March, and then the stabilization in April. Obviously there was a lot of noise during that period, particularly in March, but I think the stabilization in April is kind of interesting. If you could just give us a little bit more context on that, and then I have a follow-up. Thank you.

Dawn Phillipson

Hey Seth, sure. We have seen for the first quarter, number of transactions were up nicely, AOV was up—average order value was up nicely, traffic was up. So all of the metrics kind of driving for the first quarter were strong. We were really pleased with that.

John did mention that there was some weather that we saw impacting March. We certainly know here in the Midwest it's been a bit chillier than what we would like it to be. I think there's—we're excited about the touchpoints that we have coming out. Our summer catalog just dropped. I actually got it in my home yesterday, so we think that's going to be a nice traffic driver. Great touchpoints to stay top of mind with consumers and clients as they're starting to kind of emerge from the winter chill.

We think there's some good opportunity ahead of us. We are very mindful and paying very close attention to what is happening on a day to day basis, both in March and April, but yes, I think more to come when we report next quarter on how Q2 is going to perform in the balance of the month.

Seth Sigman

Got it. All right, fair enough.

Then I guess just a follow-up question on the promotional points earlier. Fully appreciating the differentiation of Arhaus product and the position in the market, I guess I'm curious, are you seeing consumers look for more discounts, right? Because you have an indirect online competitor today discussing more promotional events, potentially sharpening their pricing through this year, even some deflation in pricing. It does seem like they're seeing some improvement in trends, possibly related to that more promotional activity. So, I guess I'm curious what are you seeing from your consumer? Is there any evidence that they are seeking more value?

Dawn Phillipson

I'll take a first pass and then certainly pass it along.

What we firmly believe is that consumers in general love a discount, but our product is unique and such a great quality and great aesthetic that folks are willing to pay for it. It's unique, it's different. It's kind of what we've based our whole company around.

I think there's certainly a subset of our consumer who is a little bit more promotionally driven who might wait until we post a promo on a holiday weekend, but the majority of clients, of our clients, they know what they want. They love our product and they're willing to pay for it.

I don't know, Jen or John?

John Reed

They truly buy our product because they want their home to be really special and they want it to be—this is one or two times in their lifetime that they furnish their homes and they don't … Sure, I mean, our clients are very smart people. If we're going to give them a discount they're going to take it, of course. But that's not the—absolutely not the deciding factor. We've never seen that even through recessions and so forth. Deciding factor is it's great product, it's a very, very fair value for what it is, and it makes their home really, really special and that's what it's all about, and that's what we always focus on. Not only in the stores but in our marketing.

Seth Sigman

Okay. Thank you for that.

Operator

The next question comes from the line of Jonathan Matuszewski of Jefferies.

Jonathan Matuszewski

Good morning, John. Good morning, Dawn. Thanks for taking my questions. First one is just on your interior designer customers. We have the customer deposit number on the balance sheet, but curious if you could shed some light on conversations with your interior designer customers, how their books of business are looking and what are they hearing from their customers regarding propensity of their clients to spend in the backdrop. Thanks. That's my first question.

John Reed

Sure. Good morning, Jonathan. I just spent some time with some of them and from what I've been told by them—I haven't interviewed every single one of them, but I've talked to 10, 20 of them and they're saying business as usual. They're booked. They're packed. Getting out to our clients' homes, helping them. So many people are finishing remodels or their new homes are finally built after two or three years because everybody had to get in line for builders, which from what I understand is going to continue for the next few years. So no, they're packed. They're as busy as ever and they're not hearing from clients that say, "Hey, we're going to wait until you lower your prices," or something like that. Their homes are being done, they're finished, they want their furniture. They want to move into it and move on with their lives.

So, no, from what I've heard they're as busy as ever.

Dawn Phillipson

The data that we have, Jonathan, would support that. We're seeing the in-home designer program, the demand penetration is continuing to increase every quarter, so really pleased with that. Then the AOV still remains nicely over three times for sales that are assisted by an in-home designer, so …

John Reed

And not only our own in-home designers but we do a ton of business with the trade out there, the folks that have their own businesses. Every month that consistently grows quite a bit. I get a count on it every middle of each month on how many people we've signed up for and have bought, trade folks that have come and bought with us. It continues to grow and we don't see any slowing down at that at all.

Jonathan Matuszewski

That's really helpful. You mentioned trade. I guess my follow-up question is on the other side maybe contracts. You mentioned the Surf Lodge, you mentioned The White Elephant. Can you frame the scale of your contract business today? Are there initiatives to kind of scale this further similar to what some of your peers have done? Any color there would be helpful in terms of just initiatives. Not sure if you're trying to be more proactive in terms of going after trade consumers and designers but maybe small and medium sized businesses or hospitality. What's the opportunity there? What's the priority level? Thanks.

John Reed

Great question, Jonathan. I'll let Dawn jump in, but yes, it's a part of our business. It's a smaller part of our business. It's one that we've talked about. We do have a team focusing on it, and we think there's a good opportunity to grow that and grow it significantly. As I'm sure all you guys know, the hospitality business is back in business finally, and they're renovating their restaurants, their boutique hotels. They want to look really cool. We're seeing some nice growth there, but we think we have an opportunity to do a lot, lot more there.

Dawn Phillipson

Just to add onto that, I think we have so much opportunity to grow the business overall. Contract is certainly an opportunity but it does rank lower on the priorities as we're focusing on showroom expansion and increasing brand awareness in general.

So, significant opportunity but we're focusing on the strategies that we think will drive the fastest, kind of biggest results today. Contract is certainly something that we have our eye on, but we want to make sure that we are doing—executing our strategies correctly and in a very strong manner, so making sure we don't try to execute too much too fast is important.

More to come on that one over the coming years I think, but certainly opportunity.

Jonathan Matuszewski

Makes a lot of sense. Best of luck.

John Reed

Thank you.

Operator

The next question comes from the line of Simeon Gutman of Morgan Stanley.

Simeon Gutman

Good morning everyone; hope you're good. Can I clarify something that it came more out in the call than it did in the release? The demand comp for the rest of the year I think is expected to hold or, I don't know, improve—and that may be misinterpretation—versus the overall sales guidance is now expected to maybe decelerate from your original guidance. Can you just square the two and make sure we have that right?

Dawn Phillipson

Sure, Simeon. We didn't change anything in our guidance from last quarter. Everything is the same. The full year net revenue growth, total growth is expected to be 1% to 6%. The demand comp range is negative 1% to up mid single digits, so holding steady with what we provided when we reported last quarter.

Simeon Gutman

I guess with the first quarter though being a little bit better, that's where the nuance could come in. I thought it was asked on the call that maybe something gets better or worse based on how the first quarter came in. I appreciate that hadn't been changed, but one seems to be getting better where the other one seems to be implied getting worse, but I guess you weren't trying to imply anything.

Dawn Phillipson

No. We're not trying to imply anything. I think what we're trying to say is there's a lot of uncertainty for the remainder of this year and we feel confident in our ability to hit this guide. We'll see what levers we choose to pull as we move through the year, but we feel confident in the guide that we put out there and don't think it's prudent at this point in time to make any significant changes. But not trying to imply that anything is different than what it was last quarter.

Simeon Gutman

Okay. Then a follow-up. You mentioned dry powder, and promotions were asked a couple of different ways. First, has anything changed? Is anything changing? Then, what may prompt you, I guess in subsequent quarters? Are you seeing anything at the margin, even in the second quarter, where retailers are getting a little more aggressive?

Dawn Phillipson

Our promotional cadence is pretty flat year-over-year. We feel good about how we're managing promotions. We did lap the mid single digit price increase in early April that we implemented last year, so I think that's helpful to recall.

Jen, do you want to talk about what we're seeing from a competitive set for promotional cadence?

Jen Porter

Yes. We're definitely continuing to see that elevated promotional cadence out there in the market. I think it's really interesting in March and April you saw a lot of outdoor promos going out in the market as well, so people really launching that product at a promotional rate.

As Dawn mentioned, we were very flat to last year and so, you know, we continue to just be focused on our business and driving our business, and continuing to deliver the incredible product. We're happy with what we're seeing right now. As Dawn said, we always have levers in the future if we need to pull them, but right now it's really focused on supporting that product launch, getting great marketing out there, really monitoring and gauging how people are responding to it and optimizing our business.

Simeon Gutman

Thank you.

Operator

The next question comes from the line Cristina Fernandez of Telsey Advisory Group.

Cristina Fernandez

Hi. Good morning everyone. I wanted to ask about brand awareness.

You've mentioned it a couple of times on the call about how it has increased. I wanted to see if you have measured it recently and how that number tends to be compared to six, 12 months ago.

Jen Porter

Hi Cristina, good morning. We conducted a study with an external consulting firm back at the end of last year in Q4 time period, just comparing where our brand awareness levels were to two years prior, back in 2020. We were really pleased. We did see some relative improvements versus the market, showing that we were increasing our awareness versus some of our peers. But to be totally transparent, I was actually more excited by how much opportunity we continue to have going forward. So despite those relative improvements, we're still significantly underpenetrated in terms of name recognition and brand awareness to the peers in the space. So, we have a lot of opportunity to address that.

As I touched on earlier, I'm really excited about the upcoming new store openings. We're really excited about the response to some of our more aggressive prospecting opportunities. We're really excited about some of these experiential and partnership opportunities, get our name out there.

As John talked about, I think, you know, we have an incredibly passionate team here at Arhaus. It's actually really amazing watching how passionate our internal product development teams and vendors get when they're developing new product. Similarly, our marketing teams and our stores teams are equally as excited about that.

But if I could point to one thing, I don't think we've fully realized our opportunity as a marketing team to tell those stories and really make sure that everybody out there is aware of how special our product is, how much goes into it, the materials, the quality, the obsessive attention to performance and the ability to be able to use this furniture in your day-to-day life even though it looks absolutely beautiful. So, really, really excited.

As we look at being able to introduce Arhaus as a brand to new, potential clients, they're responding incredibly well to our marketing as it stands today. But I think to John's point earlier on the call, we have a lot of opportunity to improve how we're telling those stories and how we're showcasing those uniquenesses. Really, really excited to how clients will respond to that, back half of this year and then going forward.

Cristina Fernandez

My follow-up is on the product side, so perhaps for John. You spoke about the introductions for spring/summer around outdoor. Can you share some color of what you have planned for the back half? For the fall and holiday seasons.

John Reed

New products?

Cristina Fernandez

Yes, new products.

John Reed

Yes. As Jen reminds me, we typically roll out more than she can keep up with, but the back half we're focusing on obviously indoor products. Particularly the upholstery business, we think we're going to really, really explode this fall. We got some incredible new not only fabrics but leathers that are really custom made just for us.

In our business, the indoor product, if you're not furnishing a kitchen or a bedroom, it kind of all starts with the upholstery. From there, you buy the rug, the pillows, the lamps, coffee tables and so forth. So we're focusing on delivering some really, really cool new designs, incredible values, incredible fabrics that can be used. Our clients have lives, they have families, they have pets and they're very interested in things that you can use. It isn't just a room you can lock off and look at. We think that makes us really unique in the market that we go to great lengths to make sure everything from the frames of our upholstery is almost indestructible, to the cushions, to certainly the fabrics and so forth. And then we're really, really coming out with some really cool designs that I don't think people have seen in this country. We think that's going to be exciting for the fall.

Cristina Fernandez

Thank you.

John Reed

You're welcome.

Operator

Our next question comes from the line of Phillip Blee with William Blair.

Phillip Blee

Hi. Thank you. Last quarter you initially spoke about the remaining backlog of about $100 million expected to be fulfilled in the first half. Can you share how much of that is left after the first quarter, and can you go a bit deeper into the margin impact and related fall-through expected in the second half? And should we still consider a mid teens percent of trailing 12-month sales a more normalized level of backlog? Thank you.

Dawn Phillipson

Hi Phillip. We don't want to get into the habit of disclosing backlog every time we report. We thought it was helpful just for the year-over-year comparisons to give the full year, so there is still significant backlog to push through.

Any kind of margin impact is factored into the guide relative to—I assume you're asking relative to kind of the freight component, but certainly clarify if that's not the case.

Everything is factored into the guide. We don't guide to gross margin but we did give some context on Adjusted EBITDA margin.

Then apologies, what was the last part of your question?

Phillip Blee

Just considering what a more normalized level of backlog is, is that still kind of the mid teens range as a percent of trailing 12-month sales?

Dawn Phillipson

Yes, I mean for now I think that's appropriate. As we're consistently working to improve our—from our pre-pandemic lead times, particularly around—I know the merchant team is working pretty diligently to reduce lead times on some special-order type products. So, that could come down a little bit, but for now I think just using the historical average is appropriate until we have some kind of firm strategies deployed.

Phillip Blee

Okay. That's great. Thanks.

As a quick follow-up, one of your competitors announced plans to launch a smaller format studio location. Do you view this as a potential risk to your plans to accelerate the Design Studio footprint or your ability to lease a similar sized box? Then, can you remind us the sales productivity and margins of this format compared to your traditional Showrooms? Thank you.

John Reed

Yes, we heard that too. But no, it's not changing our strategy whatsoever and we don't think it's going to impact our business. We have no idea what our competitors are doing but we've got a nice plan. Things like we just opened in Asheville, North Carolina last month and did phenomenally well. Blew me away how well they did. Places like that where there's pockets of very much wealth and—but you wouldn't want to put a full-sized store there, so our Design Studios are working well. We've got lots and lots of runway, years of runway to go on those. We're continuing to tweak them a little bit, trying to get more productivity of out each square footage, and we're just putting together a really talented team of experienced people to focus on those.

So, no. We're excited and we're not changing our strategy one little bit.

Dawn Phillipson

Then from a financial perspective, our traditional Showrooms, we have said that we're targeting a $10 million revenue number with average contribution margin of 32%. Design Studios would be a lower showroom net revenue number, but it would have a higher average contribution margin of around 35% is what we target, and that's driven by, as you can imagine, the rent and the staffing levels primarily.

Phillip Blee

That's great. Thanks.

Operator

Phillip, does that complete your questions?

Phillip Blee

Yes.

Operator

The next question comes from Max Rakhlenko of Cowen & Company.

Max Rakhlenko

Thanks a lot for taking my question. Sorry I hopped on late, in case you already addressed this, but what is your view on Arhaus' ability to hold this new higher pricing level longer term? I think you're up at least high teens compared to 2019. Do you think this is sort of the new baseline, or could you need to take pricing gradually lower over time? This is more longer term, so excluding some of the near-term promos and things like that. Just curious on the run rate for the business.

John Reed

We have no intentions of lowering our prices unless we can get lower prices from our vendors or from the freight cost. We're more than happy to pass along savings to our clients if it's appropriate and we keep our margins where we want them, but other than that we don't have any plans to continue to lower prices whatsoever, because we don't think we need to. We've got great product that's an incredible value, and it's unique. Nobody else has it in the world.

With that, our clients really desire our products and, again, they buy it because they really want their homes to be special and nice, not because they can save 200 bucks on a sofa or something like that.

I always tell my team that once our clients buy our product, six months, a year from now, they don't remember what they paid, if they got a deal or not on it. What they remember is if they love their product and their sofas sit right and they're not caving in and with cheap foam and cheap frames and all that kind of stuff. They appreciate it and they love it, and they tell their friends. But they're not saying, "Hey, look at this. I got 300 bucks off on this sofa." That's not why they buy our product. So we have no intentions of lowering our prices unless, again, we can if we get lower prices from vendors or from freight costs.

Max Rakhlenko

Got it. Okay. That's great. Thanks a lot.

Operator

Thank you. Ladies and gentlemen, that does conclude our question-and-answer session, I would now like to turn the conference over to Wendy Watson for closing remarks.

Wendy Watson

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

John Reed

Thanks everybody.

Operator

Thank you. Ladies and gentlemen, that concludes today's teleconference. Thank you for your participation and you may now disconnect your lines.