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Arhaus, Inc.

Third Quarter 2023 Earnings Conference Call

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CORPORATE PARTICIPANTS

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

Dawn Phillipson, *Chief Financial Officer*

Jen Porter, *Chief Marketing Officer and eCommerce Officer*

CONFERENCE CALL PARTICIPANTS

Steven Forbes, *Guggenheim Partners*

Seth Sigman, *Barclays*

Max Rakhlenko, *TD Cowen*

Jackie Sussman, *Morgan Stanley*

Peter Benedict, *Robert W. Baird*

Jeremy Hamblin, *Craig-Hallum*

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PRESENTATION

Operator

Good morning, and welcome to the Arhaus Third Quarter 2023 Earnings Conference Call.

At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal remarks.

Please note that this call is being recorded and the reproduction of any part of this call is not permitted without written authorization from the Company.

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

Wendy Watson

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

On with me today are John Reed, Co-Founder, Chairman and Chief Executive Officer, and Dawn Phillipson, Chief Financial Officer. After prepared remarks, they will be joined by Jen Porter, our Chief Marketing and eCommerce 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 September 30, 2023 before market open today. Those documents are available on our Investor Relations website at ir.arhaus.com. A replay of the call will be available on our website within 24 hours.

As a reminder, remarks today concerning future expectations, events, objectives, strategies, trends or results constitute forward-looking statements. Actual results or events may differ materially due to a number of risks and uncertainties. For a summary of these risk factors, and additional information, please refer to this morning's press release and the cautionary statements and risk factors described in our Annual Report on Form 10-K and subsequent 10-Q's, as such factors may be updated from time to time in our filings with the SEC. The forward-looking statements are made as of today's date and, except as may be required by law, the Company undertakes no obligation to update or revise these statements.

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

Now, I will now turn the call over to John.

John Reed

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

I first want to call out and thank our teams across Arhaus for delivering another quarter of strong performance.

We are very pleased to have reported demand comp growth of 11.7% in the third quarter, a testament to the execution of teams across the Company that are developing and delivering our heirloom-quality, artisan-crafted furniture, assisting clients in our inspirational Showrooms and via our eCommerce channel to find and purchase the special pieces that will make their spaces a home, the teams that are continuing elevate and grow our brand and ensure a first-class in-home delivery experience, and the teams that support all of the client-facing and product-facing functions. Thank you. I am so proud of all of you.

Many of you have asked why Arhaus is consistently outperforming the industry. The why is our passion and our people. We love designing and working with our incredible vendors to produce beautiful furniture that can be enjoyed for generations. Our new collections are some of the most popular we have ever introduced, allowing us to expand these collections into categories and new finishes.

We love creating aspirational Showrooms where clients can imagine the home of their dreams and expanding to new locations where new-to-Arhaus clients can experience our brand of livable luxury. We are passionate about our product and our client experience, and this is reflected in our performance.

Third quarter highlights include:

- net revenue of $326 million;
- net and comprehensive income of $20 million, with a margin of 6.1%; and
- Adjusted EBITDA of $34 million, with a margin of 10.3%.

We experienced strong demand across all regions, products and channels.

Moving to profitability, as we communicated last quarter, we saw an expected year-over-year reduction in earnings, driven primarily by costs and expenses related to our accelerated new Showroom openings and our important donation to The Nature Conservancy.

Some new initiatives I'm excited about that will elevate our client experience include:

- new processes and some key hires to provide an enhanced final-mile delivery experience;
- more in-home designers as we continue to grow this service; and
- we are also focusing on growing our trade business, where we see lots of opportunities in 2024, and beyond.

Turning to the Showroom growth, we have a very busy week, opening two traditional Showrooms tomorrow, one in Coral Gables, Florida and one in Huntington Station, New York. This will bring our year-to-date new Showroom openings to eight. Then, in December of this year, we plan to open three additional California Showrooms, Las Gatos, Palm Desert and Newport Beach.

We are very proud of how our new Showrooms perform right out of the gate, and I wanted to remind you that there is a lag before we begin to see financial benefits hit our income statement due to the normal timing between when a client makes a purchase in our Showrooms and when that purchase is delivered to the client and recognized as revenue.

Additionally, our new Showrooms are reflected in our reported Demand Comparable Growth after they have been open for 13 months and in our reported Comparable Growth after they have been open for 15 months.

We have tremendous whitespace to continue to grow our Showroom footprint across the United States and we expect to accelerate our new Showroom openings to five to seven new traditional Showrooms annually, plus Design Studios.

In 2024, we are targeting another year of sizeable new Showroom growth, with six to eight new traditional Showrooms, two new Design Studios, two to three new outlet locations, and approximately ten relocations, expansions or renovation projects. These new Showrooms are in excellent locations and varied as The Grove in Los Angeles to a new development in Oklahoma City.

In closing, as we finish out 2023 and begin to look at 2024, we are focused on continuing to expand our collection of globally-inspired, heirloom-quality, artisan-crafted furniture, on growing our Showroom footprint with several exciting new locations, and on making the investments to support our growth for many years into the future.

I'm excited about the future of Arhaus, and I look forward to continuing to share our journey with you.

Now, I'll turn it over to Dawn.

Dawn Phillipson

Thank you, and good morning.

As John described, we are very pleased with our third quarter performance.

Key items from our third quarter 2023 income statement include:

- Net revenue of $326 million, up $6 million, or 1.9%, with a 2.1% comp decline versus Q3 last year, when comp growth increased 54.3%. Demand comp growth was 11.7% on a one-year basis and 99.5% on a four-year stacked basis.

- Gross margin decreased 4% to $131 million in the quarter. The gross margin decline was primarily due to the sale of price-actioned products that were receipted with higher container costs, increased fixed Showroom costs as we expand our Showroom footprint, and higher delivery costs as we elevate our in-home delivery experience.

- Gross margin as a percent of net revenue decreased 250 basis points to 40%, primarily reflecting higher fixed Showroom costs and the higher product and delivery costs.

- Third quarter SG&A expense increased 20% to $107 million. The increase was primarily driven by the $10 million donation The Nature Conservancy, higher selling expense related to new Showrooms and demand, and increased corporate expense to the support the growth of the business.

- Third quarter 2023 net income decreased 47% to $20 million.

- Adjusted EBITDA in the quarter decreased 41% to $34 million, from $57 million in the third quarter of 2022.

Let me now move to our outlook and how we are thinking about the remainder of 2023.

As we announced this morning, we have raised the midpoint of our full year 2023 outlook for net revenue, net income and Adjusted EBITDA to reflect our year-to-date performance. Our full year 2023 guidance is outlined in our press release. This implies an outlook for the fourth quarter of net revenue of $321 million to $341 million, a comp decline of 15% to 9%, net income of $19 million to $24 million and Adjusted EBITDA of $40 million to $45 million. Assumed demand comp growth is in the low-single-digit range.

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

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. (Operator instructions)

Thank you. Our first question comes from the line of Steven Forbes with Guggenheim Securities. Please proceed with your question.

Steven Forbes

Good morning, John, Dawn, Wendy. Maybe just to start, Dawn, the demand trends you mentioned, up low-single-digits, as we think about the fourth quarter guidance here and the strength in demand that you've seen year to date, maybe just rephrase to us how we should expect the backlog to work through or flow through the income statement here over the next couple quarters.

Dawn Phillipson

Good morning, Steve. Yes. So, you know, we spent a lot of time over the last few months really digging into more granular information than what we've had in the past, and what that's really enabled us to do is get a better handle on the backlog, the abnormal backlog that kind of has been a result. It started in 2020 and has carried forward. We do expect to be through the abnormal backlog by the end of this year, so we're really pleased with that. We feel good about our strategy, our outbound capacity, our inventory buys.

There's really a few reasons for a higher normalized backlog number that we're seeing reflected in the information that we have available to us.

The first component is we're really prudently buying into newness. So, as we're thinking about newness, clients are typically willing to wait a little bit longer. We're also deploying some pretty good discipline, because we don't know exactly in a particular collection, which finish might take off and which finish might not. We have, certainly, our own beliefs and assumptions, but really being prudent in how we're purchasing into newness to preserve some working capital flexibility. That will result in a bit higher normalized backlog going forward, and kind of what we've seen over the last few years.

The second piece that's driving a higher normalized backlog number is, as we think about Showroom cadence and just the number of Showrooms that we're opening, as we're opening—in years where we're opening a high number of Showrooms, they are often heavier weighted towards the back half, and even in the fourth quarter. As we talked about earlier, we have five Showrooms opening in the next eight weeks. So, that will also result in just a higher carry-forward of normalized backlog as we exit this year. As you think about the timing between when demand is recognized in Showrooms versus when deliveries occur and are rolling through net revenue, that's certainly a component.

Then, the last piece that I would call out from a normalized backlog perspective is just there's a higher volume of clients today that are engaging in home-related projects, and whether it's a light refresh of paint, flooring, whether it's more robust renovations, you know, there's a higher number of clients who are engaged in those, so there is a client timing preference that is also resulting in a higher normalized backlog.

So, again, we entered this year anticipating that there is about $100 million of abnormal backlog. The majority of that is still abnormal, but we would expect to deliver that product by the end of the year, and then the component that is just normalized backlog will roll into next year, and then as we think about next year's revenue, that will also have a higher normalized backlog number, which would then roll into 2025.

We feel really good, in general, about client lead times and getting product to clients in their homes when they'd like it, but the backlog number is going to be a little bit higher than perhaps what it was in 2019, and prior.

Steven Forbes

Thanks for the color Dawn, and maybe just a follow-up for either you or John. A lot of focus around growth retail as it pertains to predictability around year one sales and margins, so I was curious if you can maybe remind us or inform us how the 2023 class of stores is performing relative to those pro forma targets for sales and margins, and how you're thinking about the 2024 class as it pertains to those sort of pro forma productivity targets, as well.

John Reed

Yes, sure, Steve, I can take that. To answer your question, the new stores, we are very, very happy with, they've been performing well, at or above our expectations, and we certainly see the new stores that are coming onboard here shortly to do the same. A lot of them are in big markets, where we think we will capitalize a lot of business. Others are in more mid-sized markets, that we always find we do very well, we're very profitable in. Yes, we're happy with the whole group.

Steven Forbes

Thank you.

John Reed

You're welcome.

Operator

Thank you. Our next question comes from the line of Seth Sigman with Barclays. Please proceed with your question.

Seth Sigman

Hey, good morning, everyone. My first question was really around pricing. Last quarter, you talked about a mid-single-digit average price decrease. I think there were some temporary factors in there, or other changes that would potentially continue. I'm just curious, how did that play out, how is that playing out, and what's your view on pricing from here? Thank you.

John Reed

Yes, I can take that. Good morning, Seth. Yes, I think, as Dawn mentioned before, with the container pricing, and so forth, and all this inventory we had at higher cost, we kind of whittled that down to a point where we thought we could be a little more aggressive with some of our pricing. It wasn't, certainly, across the board, by any means, it was just on some selected pieces. But, as we did that, we're happy with the performance, we've seen sales go up on certain collections, and we think we're at a perfect spot right now to be very, very competitive and hit our margin plans.

Seth Sigman

Okay. Just to follow up on that point, is your sense that others in the industry have also taken steps to refine pricing or lower pricing on the back of those lower costs? Then, my follow-up question is around the gross margin, just trying to understand. There were some pressures this quarter related to those pricing actions. How do you think about that going forward, are you kind of through that already and you could start to see more of those freight savings come through? How should we think about that? Thanks.

Dawn Phillipson

Good morning, Seth. As we think about the gross margin pressures in the third quarter, when we were talking in the second quarter, we had said we felt like the freight benefits that are flowing through would offset some of these price reductions, and there's a couple of things that caused that not to be exactly as anticipated.

The primary reason is that the mix shift, the product mix shift really skewed a bit more towards these price action SKUs versus what we originally anticipated, so we saw that those items were really resonating with clients at these price points. The great news is that we are clearing through the product a bit faster than anticipated, that we wanted to, but that means that there is a little bit of gross margin compression related to that, that was unanticipated at the time.

I think, as we're thinking go-forward, keep in mind as demand is written and we had great demand in the third quarter and that takes some time to flow through the P&L and to be delivered. So, I would expect some margin impact from these prices over the next few quarters as product is being delivered, and then keeping in mind that we're not through all of the inventory that we would like to be through, so demand will continue selling. A lot of these products that we took price actions on, they were receipted at those higher freight costs. Then, just keep in mind that all of this is factored into the guide already, so just an added piece there.

Then, from the market perspective, we closely track and monitor competitors and what they're doing. We still believe that our value proposition is excellent and industry-leading, so we really remain focused on that and making sure that our value proposition is where we want it to be. We're comfortable at the moment with how we're positioned in the market.

Seth Sigman

Okay, great. Thank you both.

Operator

Thank you. Our next question comes from the line of Max Rakhlenko with TD Cowen. Please proceed with your question.

Max Rakhlenko

Great, thanks a lot. First, can you frame how much of the strong demand in 3Q came from new products versus the core, versus some of the end-of-life or other products that you took price actions on? Thank you.

Dawn Phillipson

Good morning, Max. You know, we don't want to get that granular. I think what's important to note is that we have a good handle on the inventory with regard to price-actioned SKUs. Clients responded to it a little bit faster than anticipated. We did have a phenomenal September with our marketing campaigns, that really resonated with clients. So, you know, overall, we're pleased with the demand that we saw. Everything, you know, all the different components that you're asking about is factored into the guide for the fourth quarter, certainly, and then as we move forward and report and guide to 2024, it will be factored in, as well.

But, Jen, do you have any context you'd like to add on the marketing campaign?

Jen Porter

Yes, good morning, Max. Yes, just to emphasize the point that Dawn just made, we had—we were really, really pleased with the results of our fall campaigns. Our fall catalog and collection launch hit at the end of August, and just incredible consumer response to that, both in terms of engagement and driving traffic into stores and onto the site to purchase those new products. We're also continuing to see really, really strong engagement with our ongoing collections that weren't part of the price action process, our top sellers there. As you may remember, we launched our Rooted campaign in early August of Q3, which was telling the story of one of our incredible vendor partners down in Mexico, one of our top collections that really has been performing well with clients for a couple of years now, and being able to share that additional knowledge and detail and storytelling about what makes that truly special really resonated with the business. So, we're really, really happy, and really happy with the client health we're seeing across both new and existing clients reacting to both of those price-actioned SKUs, but also, excitingly, about all the new products and the product that wasn't included in that category.

John Reed

Yes, and, Max, I'll just add something to that, as well, on the product side. The current product, the existing product that we've had is doing great. We're not seeing a slowdown on most, if any, of the current product that we've had, you know, that we've had for a while. Then, on top of that, the new product has just been a homerun, as well. So, we're happy with the whole mix of product. We think we're certainly kind of leading edge on the design side and people are really resonating with it, but our core products are doing well. Over the last four years, we're up 99%, and so you can see, if you do the math on that, that people like our product. In the last two years, we're up almost 28%. So, it's been a nice ride here and we think we're hitting on all cylinders.

Max Rakhlenko

Got it, that's very helpful, and just sticking with that last point that you made, you're meaningfully out-comping peers and taking significant market share. What is your sense of how your awareness levels are now trending, and do you feel that you're starting to move in the right direction? Then, ultimately, over the medium term, where do you think that that can go, as I think you used to do surveys where you were still meaningfully behind peers?

Dawn Phillipson

Yes, Max, great question. The simple answer is, yes, we definitely think our brand awareness is growing. I think there are a number of factors driving that.

First and foremost are the new Showrooms that we've been opening this year, and they're going to be continuing to open aggressively into next year. As I mentioned before, new Showrooms, and Showrooms, in general, are the number one way that new clients are discovering Arhaus as a brand. So, as the teams are really focused on opening up these incredible spaces in new markets and filling out existing markets, we're really pleased with what that's doing to increase awareness.

In addition to that, building off of what John was just saying about people like our product, they're really responding to it, our teams have really been focused on all aspects of service, on quality, on making sure that clients continue to have that incredible experience.

The number two way that new clients are discovering Arhaus is through recommendations from friends and family. That is incredibly important to us, it's something we're really proud of, we really work very hard to maintain. It's one of the reasons we are putting so much effort into the storytelling and into being able to showcase how special our product truly is, and really focused on ensuring that clients are happy, so that then they're sharing their love for the brand with their friends and neighbors and family for years to come.

In addition to that, I think we've been doing a lot of things right for the last few years, and for the decades before that. We had an incredible brand awareness opportunity four years ago. We continue to have an incredible brand awareness opportunity now, we are making really good progress towards that, but there's a very long runway for us to continue to do that. As we continue to open up new Showrooms, we continue to get better at telling our story, we continue to get better at creating that really omnichannel experience. We know our Showrooms are the best showrooms out there, our teams are incredible, and we've been working really hard to bring that same experience and emotional connection to life online through Arhaus.com, through digital advertising, through social media, and all of those channels, and we think we've done a really great job of that over the last few years, but we have so much more to come. I'm really excited about what the team's working on and how we can continue to build that.

So, the short answer is, yes, brand awareness is growing, but huge potential for that to continue to grow in the future.

Max Rakhlenko

Great, thanks a lot. Best regards.

Dawn Phillipson

Thank you.

Operator

Thank you. Our next question comes form the line of Simeon Gutman with Morgan Stanley. Please proceed with your question.

Jackie Sussman

Hey, guys. This is Jackie Sussman on for Simeon. Thanks so much for taking our question. I guess, first, the demand comp has been very healthy the past couple quarters, despite a negative low-single-digit actual comp. I guess, at what point will demand comps translate into positive actual comps? I guess, along those lines, is the outbound capacity issue getting incrementally better or any (inaudible)? Thank you.

Dawn Phillipson

Good morning, Jackie. We talked last quarter about the outbound capacity, in particular, around Dallas and how Dallas is a bit less productive than what we had originally planned by this point in time. The good news is, is that over the past several months, we have had—we've made some system changes, but have really alleviated any kind of delivery constraints that we have with regards to Dallas. Now, it doesn't mean that Dallas is as productive as what we would expect at this point in time, but it does mean that Ohio and North Carolina are compensating, based off of some systemic and inventory allocation components, that we're still working through. So, that's the good news there.

With regards to the comp, keep in mind that the base for the demand comp and the base for the comp coming out of 2022 are very different. If you remember, we pushed through a significant amount of the backlog, the abnormal backlog last year, which was about $150 million. That was all pretty much driven in the second half. So, keep in mind that that baseline is just going to skew the numbers from that perspective. But, we feel really good about our demand, how our product is resonating, our marketing touch point. Some of this noise in the numbers will shake out as we normalize and kind of lap the normalized backlog number next year.

Jackie Sussman

Got it, thanks so much, and if I can squeeze in one more. Just on SG&A, I think that came in a lot better than at least what the market was expecting. I guess, is there any way—did you adjust anything on the SG&A line intra-quarter based on what you were seeing in the environment, or were there kind of broader cost-reduction efforts done independently of what you were seeing in the quarter, for this quarter?

Dawn Phillipson

You know, we're constantly evaluating our cost structure, and it could be anything from timing of new hires, new systems deployment, changes, just based off of operations and how things are flowing, not necessarily to drive to a specific cost number, but just we're a dynamic business, things are changing and can be fluid. I still feel good about the expenses that we have in place. Some of the systems initiatives will shift just based off of changes in the business, which then, accordingly, changes how that flows through the P&L from a timing perspective, but, in general, we haven't made any significant SG&A shifts relative to what we would have anticipated last quarter or the quarter prior.

Jackie Sussman

Great, thanks so much.

Dawn Phillipson

You're welcome.

Operator

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

Peter Benedict

Hey, good morning, everybody. My first question's just on gross margin and kind of some of the commentary as we look forward. You mentioned the response to the price-actioned items. You've obviously got a lot of stores opening, so occupancy costs will be going up. I'm just curious, that third quarter level of 40%, is that kind of a new kind of baseline that we should be thinking about as we look out over the next few quarters? That's my first question.

Dawn Phillipson

Good morning, Peter. We don't guide to gross margin. I think there's a lot of things happening in that margin line item.

First being the product cost related to the price action SKUs that were receipted at the higher container cost, that'll take a few quarters to kind of work through to get the inventory where we want it to be, before we then take any additional price action.

Delivery costs, I think is something that we are actively really investing into. As we think about the in-home delivery experience, that's really our last touchpoint with the client on any particular order, and we want to make sure that experience is really seamless and beautiful as we're entering their home. Accordingly, we've hired an SVP of Final Mile, she joined us about six months ago, and she has some really great ideas and ways to invest, that we think will really elevate the client experience. So, we're pleased with kind of the results that we're seeing to date on that from a client experience perspective, and we will continue to invest in that side of the business over the next several quarters.

Then, of course, the Showroom rents, as we are opening new Showrooms. John mentioned earlier that we have a pretty exciting slate for next year, as well. Just keeping in mind that those expenses start to roll in up to 12 months prior to any top line benefit. It's a little bit of a moving target, as you think about the Showrooms that opening today, with all those expenses. A lot of them are in California, and so they're heavier rent expenses, and we will start to see some nice top line come in on those over the next several quarters, but then we do have additional Showrooms next year that will be rolling in.

So, I guess those are just some of the kind of puts and takes that I would encourage you to think about.

Peter Benedict

Got it, okay, thank you, and then just a question on kind of CapEx and cash. The CapEx planned for the year was taken down a little bit. I'm not sure what was driving that. Maybe you can help us understand that. Then, this quarter, probably over 20% of your market cap is in cash, a good position to be in, but just curious, is there a point in time where you kind of look at the cash balance and say, "Hey, there's something we want to do with this," or just curious your thoughts on that front? Thank you.

Dawn Phillipson

Sure. CapEx reductions are really just timing related. As we think about Showroom opening, Showroom spend and the timing of which, as we're working through when we take possession of 2024 locations and when we start planning on those, it's really just timing, there's no change in strategy. As we look out to next year, it's just a flow between years.

Then, with regards to the cash balance, we are focused on reinvesting back into business for growth. We have a ton of whitespace opportunity. We have a lot of opportunity beyond Showroom expansion, as well. John mentioned the trade program, which we're looking at, how we can really kind of dig in there and build that business and grow that opportunity. I'd say more to come on that, but we, internally, are having a lot of discussions on what is the best use of that capital to drive a nice return for the organization.

Peter Benedict

Great, thanks so much. Good luck.

Dawn Phillipson

Thank you.

Operator

Thank you. Our next question comes from the line of Jeremy Hamblin with Craig-Hallum. Please proceed with your question.

Jeremy Hamblin

Thanks, and congrats on the strong momentum in the business. I want to come back here to performance in the quarter. Your eCommerce business was up 26%, versus the retail side of the business down 2.7%. Just in terms of thinking about the pricing actions and kind of that interplay between eCom and your retail store channel, is that a reflection of the pricing actions being maybe more powerful on the digital side of your business? I wanted to just understand. You saw a pretty significant reacceleration here in Q3 in that channel of business specifically.

Dawn Phillipson

Good morning, Jeremy. I would encourage you to remember that what's reported from a channel perspective in the Q is really based off of delivered, so less about kind of the underlying demand trends in the organization and really more around just timing of deliveries, but with that being said, certainly, some of your commentary is valid, so I'll pass it over to Jen and she can talk about the eCom drivers.

Jen Porter

Yes, good morning, Jeremy. Yes, I mean, we're really, really pleased with e-Commerce. We've seen strong traffic, strong conversion, strong engagement, strong sales, to your point. We definitely do see our clients respond to and react to price actions digitally. They find them, they come in. We also spoke on our last call about the team really focusing on how we are merchandising and displaying pricing actions and sale product on our site, so we're really pleased with the reaction and engagement there, so definitely seeing a response there. I do think that that is somewhat stronger on eCom and digital channels than in retail, just because it's more prevalent, it's easy for that consumer to find their way to the sales section and see all that product and shop it directly.

Having said that, though, we are incredibly happy with how our clients are responding to our full price product on eCom, as well. We're seeing really great engagement with that product. We're seeing really great sales on that product on our eCom channel. We also know that the majority of our clients who are ultimately making purchases in our retail Showrooms are starting their journey or at some point continuing their journey on eCommerce, as well.

So, from where we're looking at, we're seeing a really healthy growth of our eCommerce business, it's been really strong all year, we're happy with the Q3 performance. One of the things we've talked about for the last couple of years is growing eCom not only as a sales channel, but also as an omnichannel presence to uplift our total Company business has been a real focus since the relaunch of our site about two years ago now, and the teams continue to look at that. But, overall, we're really happy and we're going to continue to focus on building that channel out going forward.

Dawn Phillipson

I would just add to that, that even with the price action that we've taken in mid-June, we have seen really nice lifts in AOV, so I think that also kind of lends to the strength of our newness and kind of core business that was not a price-actioned piece.

John Reed

Just one last thing on eCom, is as we open these new stores and new clients find us, we see in those areas our eCom business go way up, as well. The new stores and renovation stores, and so forth, really help drive the eCom business, as well, because people come in the store, they sit on things and they go home and order it online, and that goes both ways. We know people that have come in the stores have already been on the web and studied our products, and so forth. So, it really works in conjunction and we're very happy with the performance of both the stores and the eCom business.

Jeremy Hamblin

Great, and then just a clarifying question here. Still significant noise around backlog. I think in prior commentary you'd indicated that kind of excess backlog delivered in Q4 last year was about $40 million. If we look at the midpoint of your guide here for Q4, $331 million versus kind of $316 million last year, adjusted for that excess backlog delivered, in terms of that upside, and, obviously, if you have positive written order growth, are we kind of apples-to-apples? Are you kind of implying that the business will be positive ex the normalization of backlog, or however you prefer to characterize it?

Dawn Phillipson

I think one point of clarification is that last year we had about $150 million of abnormal backlog in the second half of the year. This $40 million is not the only backlog that was in the fourth quarter. That would be a portion of the abnormal backlog that we hadn't anticipated, that flowed through a little bit quicker than anticipated due to Dallas opening so strong. I think, keeping in mind that of the $150 million, $40 million was expected in 2023, but pulled into '22. The balance of $110 million of backlog was spread over Q3 and Q4. So, just a clarification point there, which I know backlog has been a bit confusing to folks. Hopefully, that's helpful.

As we think about this year, we will still have some abnormal backlog deliveries in the fourth quarter of this year, so I think a little bit of noise in 2023 from backlog against a little bit of noise in 2022 of backlog. I think the great news is that we'll be through it all by the end of this year, and then in 2024, we can have a clean slate and really just be back to a normal business cadence, so we feel good about that.

Did that answer your question? Is there more I can elaborate on?

Jeremy Hamblin

I think by the end of the year, it sounds like it'll be cleared through the abnormal backlog.

Dawn Phillipson

Yes.

Jeremy Hamblin

Thank you.

Dawn Phillipson

Thank you.

Operator

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

Jonathan Matuszewski

Great. Good morning, and thanks for taking my questions. The first one was just on the demand comp guide. Just curious if you could give us a justification for that, you know, coming off of the strong 12% demand comp in 3Q. I'm curious whether kind of that low-single-digit is reflective of what you're seeing in October, or just conservatism in anticipation of slowing in November and December. Thanks.

Dawn Phillipson

Good morning, Jonathan. We're really pleased, of course, with the third quarter demand comp. We're very pleased with what we saw in October, which was above the low-single-digit that we're guiding to for the fourth quarter. As we think about November and December, in November of last year, we had some promotions that we will not be comping this year. As we think about the price actions that we've taken in June, and just overall product portfolio, we're being a little bit strategic in the promotional cadence for November, so keeping that in mind, along with just general macro uncertainty around the consumer, which I guess persists for several years now. But, yes, just kind of being conservative in our view of what may happen in the fourth quarter. That being said, our product continues to resonate, the marketing continues to resonate, so pleased with what we're seeing.

I would also just remind everyone that we are not a holiday-driven business, from a demand perspective. While we do have a holiday assortment, that's not a significant driver of our business. Most folks aren't purchasing sofas or desks as holiday gifts. Just a little added context there.

Jonathan Matuszewski

That's helpful, and my follow-up question is on the potential for membership. Some of your competitors offer this. You could argue that the backdrop for the consumer in housing in '24 would maybe not be ideal for launching that, but on the other hand, you know, your brand is clearly on fire, so would you say you're more or less likely to pursue membership than you were a couple of months ago, and if you are more seriously contemplating it, what would be the aspects that attract you to that? Thanks.

Dawn Phillipson

Thank you, Jonathan. We have a lot of active debate over our pricing strategy internally, and have for several years now. The question is what is the right time to deploy a new pricing model. A membership model is one of a few of them that we're discussing and looking into, but until we have a better handle on when we would want to deploy a new pricing strategy, I think we're going to kind of keep that a little bit close to the vest at the moment. Absolutely agree that we are actively engaged in what our pricing model and what our pricing strategy should be, but nothing to note at this point in time for you.

Jonathan Matuszewski

Great, thanks so much.

Operator

Thank you. Our next question comes from the line of Cristina Fernandez with Telsey Advisory Group. Please proceed with your question.

Cristina Fernandez

Hi, good morning. John, on your comments, you talked about a couple of initiatives for next year. I think they were a new process for delivery, the trade business, interior designers. I wanted to see if you could expand sort of exactly what are your thoughts on being able to grow those businesses and what are you going to do differently?

John Reed

Sure. Good morning. Yes, as I mentioned, the trade business is one we're focusing on. We've seen some really nice growth in that business in the last couple years, and so it's one that we think there's a lot of white-space there. These are outside trade members who, basically, have their own businesses and we're finding if they can come to us and do kind of a one-stop shop, we give them the service they need, they're really responding well. So, we think that's a great business.

Our own interior designers, we added—or started that program, I don't know, four years ago or so. We continue to grow it. We continue to add more interior designers to stores, because they just can't keep up with the demand. So, we're seeing some really nice growth there and we're focusing on that, as well.

Certainly, as we mentioned, we're opening more new stores and renovating more stores than ever in the history of the Company, so that, we see driving our business, as well, big time. When we open a new store or we renovate or move an existing store with the old design model to the new design model, we see a great lift in sales on those, as well.

Those are kind of the three things we're focusing on, not to mention the furniture, the product, which is what we're all about. If we have great product, if we execute right, if we show it off right, and we do, our business continues to grow. We've got an incredible Design Team, as well as a Product Team, a Sourcing Team, that continues to come up with new product, and product that really resonates with our clients. Really, when you think about it, that's why we're in business. People buy furniture from us and we deliver it to them and we make their homes a much better place than they were. So, every day, we focus on the product, as well.

Cristina Fernandez

On the product side, any categories that you're looking to expand in 2024, whether it's outdoor, or any others you want to call out?

John Reed

Yes, we're looking across all the categories. As you mentioned, outdoor is one that we had focused on during COVID and we continue to grow it. The growth on it has been really—we've been very happy with it. With that, we kind of look at each room in the house and say how can we grow the dining business, how can we grow the living room, you know, great room business, and a lot of it is finding really great products and then expanding on the SKUs of those products to fit everybody's needs, because everybody's room is a different size, a different shape, different configuration. If we have a coffee table in one size or we carry it in five sizes, we see a nice lift in the product as we expand our product that people love. We generally start rather conservative and then if we see it's working, then we'll jump on it and catch up to carry it in many different sizes and SKUs, and even finishes, and so forth. So, that's a great way to grow the business, as well.

Cristina Fernandez

Then, one last question. I wanted to see if you can talk about the Company's kind of broader sustainability initiatives. Should we think about the donation to The Nature Conservancy, you just did it one time, or if it's going to be a recurring program and next year we could see other donations, whether it's to the same organization or others?

John Reed

Yes, we've had a lot of debate on that. As you all know, our world is burning up and we feel compelled to help, if we can. With that said, we don't have any plans right now for 2024 to repeat what we did. It was kind of a one-time opportunity that we really didn't want to pass up. We're always keeping our eyes open, but right now, I think in the plan and the budget that Dawn's publishing here soon internally, we don't have that in the plans.

Cristina Fernandez

Thank you.

Operator

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

Peter Keith

Hey, good morning, everyone. Nice results here. I wanted to just kind of reflect back on your strategy around Labor Day Weekend, where I think you extended a number of days around your advertising. Industry-wide, we do continue to hear about these peaks and valleys of how the weekend is being bigger and the troughs being lower. How should we think about your success for Labor Day Weekend, and then, carrying that forward, do you see more opportunity to extend, I guess, your visibility and advertising on upcoming holiday weekends?

Jen Porter

Good morning, Peter. Good question. As you mentioned, that heightened promotional environment is still out there. The lengthening of times around those key selling weekends, we continue to see that happening. We are pleased with the results of Labor Day. As we spoke about on our last few calls, we do have that subset of our clients who is very promotionally driven, and that's in the growth stage, we want to be part of that consideration set, and so we were really happy just lengthening the time of the marketing of that promotion for Labor Day. But, looking forward to November and December, as Dawn mentioned earlier, we're not expecting to accelerate our promos over last year in any way. We do anticipate, similar to last year, that the Black Friday promo is being pulled forward earlier and earlier in November. If you look out in the industry, we're seeing brands start their Black Friday promos in October of this year, so it's definitely happening there. So, I think you can expect to see that earlier conversation about promo around the Black Friday Weekend similar to what we did last year, but we are not expecting to accelerate our promotions and are actually decreasing a little bit from what we did last year.

Peter Keith

Okay, thank you. I guess my second question would be to Dawn. Dawn, I know you're not a company that guides quarterly, but we can back into an implied Q4 guide, given the detail that in the press release. So, the heart of my question is—just the margin decline in Q4, it seems like it's going to get worse in Q4 than it was in Q3, and that's without the $10 million charitable donation. The demand trends are great, but there's just a lot of noise in your margins right now. I was wondering if you could just maybe take a step back for everyone and help to highlight the brush strokes of what's pressuring margin; and is the margin decline in Q4 ideally sort of the trough with the declines, and as we get through some of these timing dynamics, that the margin decline should be less meaningful in the quarters to come for '24?

Dawn Phillipson

Yes, good morning, Peter. Keep in mind that the—from a margin rate perspective, last year, it had significant impact and we saw some really nice leverage on the backlog delivery, so artificially inflated just from a timing perspective when we're looking at the comparative. As we look forward over the next several quarters, years and think about what's going to be impacting the business, in the near term, certainly the price actions in June that we took, those will continue to have an impact as we're right-sizing the inventory and kind of clearing through the end-of-life inventory. Showroom occupancy certainly will continue to persist, as we think about the strong opening cadence that we have for next year, that we're really excited about, which will have—long term, it's the right thing for the business to do and it will have benefit. It's just timing related there, as well.

Then, we've always said that we expect margin expansion, but it may not be entirely linear for us. As we think about all of the areas of the business that we're reinvesting back into, we're really taking our time to make sure that as we're scaling the organization from $1 billion to $2 billion, and beyond, that we can grow it more efficiently. In the near term, that does cause some compression. We talked a little bit about the in-home delivery experience and how we're trying to elevate that. Over time, that's going to have a great, great impact on the business, as you think about just the word-of-mouth, that brand awareness component.

As we think about within SG&A, as we think about the investments that we're making in the business to really drive the back office, which often isn't as exciting to talk about as product and Showrooms, but it's very important to us. So, as we're thinking about our warehouse management system that's deployed in our North Carolina facility this year, as we're looking to deploy that in first quarter next year in our Ohio facility, there's always—any time we deploy a system like that, there will be a little bit of noise in the top line. As you think about for our warehouse management system, you have to close the facility for a few days to do the inventory conversion, and just, you know, some of those systemic components. We're also working on our planning software, which is going to be vastly critical for us as we think about inventory allocation and making sure that we can drive efficiencies in linehaul expense and moving product, very heavy, very bulky, very large product through the network. We're also in the process of deploying our manufacturing ERP, which is going to be really critical to give us great visibility to our operations there from a bill of materials perspective, from a process perspective.

So, lots of really great things, but in the near term, these will compress margins. We do expect expansion longer term. We're really excited, as we continue to grow that top line, what that's going to look like from a financial perspective, but we're trying to give ourselves a little bit of breathing room to do the right things for the organization, the right things for the client, and long term, it's going to be, I think, really great for the organization as a whole.

Peter Keith

Okay. Just to round that out, and I can appreciate all the growth investments, but you did mention two big timing dynamics of backlog and you've got five new stores coming in, so, again, is Q4 potentially the worst of the year-on-year declines, to the best of your visibility on sales trends?

Dawn Phillipson

You know, we haven't guided to anything for 2024 yet, so I don't want to kind of get out over my skis there, but, certainly, the math would indicate that the year-over-year component would be quite significant in the fourth quarter, yes.

Peter Keith

Okay, all right, sounds good. Thanks, guys.

Dawn Phillipson

Thanks, Peter.

Operator

Thank you. Our next question comes from the line of Phillip Blee with William Blair. Please proceed with your question.

Phillip Blee

Hi, everyone. Thank you. Given the big year ahead for new Showrooms and refreshes, can you maybe speak a bit about the changes you've made to them over the past several years that have had a direct benefit on productivity versus pre-pandemic levels, maybe from a physical location, but also inside experience; and then should we expect rent per square foot to continue to accelerate quite a bit on these higher profile locations being opened? Thank you.

John Reed

Sure, I can talk about the renovations and how it's working. Yes, four years ago, we dramatically changed the looks of our stores, made them a lot more user-friendly, just a lot more emotionally driven, that when folks walk in, they love all the furnishings, the way we design things, we put in Design Studios, we put in fireplace rooms, things that just warm up the store quite a bit. As we've been doing that, as—I think we mentioned as leases come up, we will decide do we want to keep the store and renovate it, do we want to move the store. In either case, normally, we will renovate a store when a lease comes up, if we do decide to keep it. If not, we'll move it. But, we see an impact in not only customer sales, but also in our clients tending to come back again and again and hop on the web and order more. So, it's been a nice, nice change. I think we have a lot of product, a lot of renovations and moves coming up this past year and a lot more, I believe, in '24. So, it's a very good thing. It just elevates our brand to a point where the product just looks better, and when it looks better, you know, the clients tend to buy it, and it really sets us apart from the competition, as well. We think the way our stores look is really, really enticing, and we hear it all the time. Certainly, new stores, when people walk in them, they're kind of blown away, because they've never seen anything like it, and we'll hear that through the years to come in all our stores as new clients come into them. So, it's been a very, very good thing.

Dawn Phillipson

Just from a kind of a tactical perspective, in our filings, we do not break out Showroom rent versus other leases, so that rent number or that lease number that you're seeing in there is for everything from computers to rent to distribution center, so keep that in mind. Now, from kind of an operational strategic perspective, we are opening Showrooms that are a bit more expensive from a rent perspective. We do believe that those Showrooms will have a higher top line, though. So, we're looking at the opportunities very holistically from an investment perspective.

Phillip Blee

Okay, great, and then one quick follow-up. Can you provide maybe a bit more color on inventory? We saw it decline this quarter. How should we think about the go-forward rate, balancing new Showrooms and new products, versus cycling through some of the higher cost price-actioned SKUs? Thank you.

Dawn Phillipson

Yes. So, you know, we continue to work through the inventory assortment. I think we feel good about how we're handling newness. We feel good about the core assortment, our best sellers. We do still have a little bit, you know, pockets of inventory where we're a bit long, still continuing to work through the inventory, that over the last two years, we haven't really focused on it from an end-of-life perspective, so continuing to work through that to get the inventory levels right-sized to where we'd like them to be. We have a new—we're continuing to refine our planning organization and our planning processes, and, honestly, the strategic viewpoint at which we take an inventory approach. So, more to come on that, I think, as we also are working to deploy the demand forecasting software with regards to planning, and certainly allocation software we're planning, but, overall, we feel pretty good about our inventory, recognizing we do have some pockets that we're still trying to clear through. So, yes.

Phillip Blee

Great, thank you.

Dawn Phillipson

Thank you.

Operator

Thank you. Our final question comes from the line of Vicky Liu with Bank of America. Please proceed with your question.

Vicky Liu

Good morning. Thank you for taking my questions. This is Vicky on for Jason Hass. My first question is related to the cadence through the third quarter. Given the strong marketing campaigns, did you see an acceleration through the third quarter?

Dawn Phillipson

Sorry, are you referencing an acceleration of demand through the months of the third quarter, is that the question?

Vicky Liu

Yes.

Dawn Phillipson

Okay. We try not to parse it out too much, certainly, because we know that one quarter does not make a month, and we do feel very strongly and invest deeply into our marketing campaigns and are pleased with how those performed. A lot of those catalogs went out the end of August. But, yes, I think, overall, we're just pleased with the consumer response to the product.

Vicky Liu

Thank you, that's helpful. Then, as we focus on the Showroom openings for next year, I know you have great pipelines coming up, how should we think about the selling expense per store and how does it compare to this year?

Dawn Phillipson

As we're working out towards those, we're still refining the timeline. We certainly have a timeline today, but we know that Showrooms can shift within a year, which then can have an impact with hiring staff of those locations. But, I would say, typically, just looking at the cadence here, it's not that dissimilar from 2023.

Vicky Liu

Okay, yes, thank you.

John Reed

Thank you.

Operator

Thank you. We have reached the end of our question-and-answer session and I would now like to turn the floor back over to Wendy Watson for closing comments.

Wendy Watson

Thanks, everybody, for joining us today, and we look forward to talking to you again next quarter.

John Reed

Thanks, everybody. Have a great day.

Operator

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