



**Arhaus, Inc.**

**Second Quarter 2024 Earnings Conference Call**

**August 8, 2024**

## C O R P O R A T E P A R T I C I P A N T S

**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 & eCommerce Officer*

## C O N F E R E N C E C A L L P A R T I C I P A N T S

**Simeon Gutman**, *Morgan Stanley*

**Max Rakhlenko**, *TD Cowen*

**Steven Forbes**, *Guggenheim Securities*

**Seth Sigman**, *Barclays*

**Robby Ohmes**, *Bank of America*

**Sabrina for Phillip Blee**, *William Blair*

**Peter Keith**, *Piper Sandler*

**Jeremy Hamblin**, *Craig-Hallum*

**Cristina Fernandez**, *Telsey Advisory Group*

**Peter Benedict**, *Robert W. Baird*

**Jonathan Matuszewski**, *Jefferies*

## P R E S E N T A T I O N

### Operator

Good morning and welcome to the Arhaus Second Quarter 2024 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' Second Quarter 2024 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 June 30, 2024 before market open today. Those documents are available on our Investor Relations website at [ir.arhaus.com](http://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 most recent 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 turn the call over to John.

**John Reed**

Good morning everyone and welcome to the Arhaus second quarter conference call.

Our team delivered another quarter of solid operational execution, with several new Showrooms opening, successful new product development and important strategic investments made to support our long term growth.

In the second quarter, we delivered net revenue of \$310 million dollars, net income of \$22 million dollars and Adjusted EBITDA of \$40 million dollars. During the quarter, we saw demand comparable growth soften to a decline of 3%.

On a two-year stacked basis, demand comp growth increased 8.6% in the second quarter, and on a three-year stacked basis demand comparable growth increased 31.1%. We're very proud of our strong growth over the past several years and expect to continue to grow our demand comp mid-single digits in the long term, even as there is near-term contraction related to the macro environment.

July's demand comp accelerated the second quarter trend with a high teens decline, resulting in a two-year stacked demand comp decline in the low-double-digits and a three-year stacked low-double-digit demand comp increase.

Demand metrics in the second quarter were mixed. Our average order value and comp traffic were down. Conversion was down slightly year over year, but up sequentially from the first quarter. Transactions in the second quarter were positive and orders over \$5,000 and \$10,000 continue to grow nicely. We also saw solid growth in new customers in the second quarter and total traffic was up.

Total demand in the second quarter increased mid-single digits. We continue to be very pleased with the new Showroom performance and our Showroom expansion plans.

Dawn will discuss in more detail later in the call, but given the current consumer backdrop and industry trends, as well as our own demand comp trends over the past three months, we are adjusting our expectations for the second half of the year and lowering our full year outlook.

While our net revenue and earnings outlook are not what we originally expected for the second half of this year, I am confident we have the right strategy, the right product and the right marketing to continue to successfully grow over time.

We have extensive experience navigating cyclical consumer environments, where we maintain focus on expense control, while our strong, debt-free balance sheet allows us to continue to execute our strategic growth plans. During times of economic softening, we have and will continue to invest in product, marketing and showrooms. As we have done before, we are confident that this approach will enable us to emerge from this cycle in an even stronger position.

We will continue to advance our growth strategy by enhancing and elevating our product assortment, expanding our showroom base, increasing brand awareness, and making the strategic investments necessary to upgrade our infrastructure and improve our business tools to support this growth.

Our growing Showroom footprint with two primary formats continues to drive brand awareness and our long term growth. We have opened eight new Showrooms in six states so far this year, and opened our 100th location! I want to thank our teams across Arhaus for their efforts in achieving this important milestone in our journey.

Just since late May, we have opened three incredible new traditional Showrooms, which are our large format, in three fabulous centers in California: The Grove in Los Angeles, The Beacon La Costa in Carlsbad and Stanford Shopping Center in Palo Alto.

Today, we have 83 traditional Showrooms, only half-way through our goal of 165 traditional Showrooms. Our 165 traditional Showrooms goal is based on very attractive markets we have identified through our experienced real estate team. We perform robust analytic work around our location list and have more opportunities than we choose to execute in any given year. Our model is successful in a variety of markets and across all geographies, allowing us the opportunity for significant expansion. In short, we couldn't be more excited about the new location opportunities ahead of us.

As you know, we are also thrilled with our smaller Design Studio concept and last week opened our second Design Studio of the year in Peachtree City, Georgia. Our skilled real estate team has identified 100 locations for Design Studios, and while we are early in our growth journey with this footprint, we are incredibly pleased with the performance we've seen, with Design Studios outperforming the balance of chain.

We are on pace to meet our Showroom opening goal for 2024, with a design studio in the Lake Norman, North Carolina area and traditional Showrooms in Oklahoma City and Corte Madera, California slated to open later this year. As I mentioned earlier, we are pleased with the performance of our new Showrooms and our new Showroom economics.

Moving to our brand awareness, this is a significant opportunity as more and more potential clients become familiar with Arhaus. The top two ways we increase brand awareness are through opening new Showrooms and recommendations from friends and family.

From our nearly 40 years in the industry, we generate our strong recommendations from friends and family because of the factors that set us apart in the premium home furnishings industry: our exceptional product and the value proposition it represents; the unique, artisan nature of our aesthetic; the time we take to understand our clients' wants and needs in their homes and matching that with our livable luxury approach; the inspirational and aspirational experience in our Showrooms; the ability to match our clients with our complementary in-home designers, and the ease with which we work with our clients' own interior designers; and our focus on creating the best in-home delivery experience in the industry.

Speaking of product, we cannot wait for you to see our new fall collections which will begin arriving in Showrooms at the end of this month, at the same time our fall catalog will start arriving in homes. It is a stunning catalog, and we have meaningfully increased circulation with prospects to drive brand awareness.

We are introducing some incredible new collections that build on the success of some of our most popular pieces. You will see stunning new wood finishes that we are very excited about, and new curved takes and wonderful fabrics in our upholstery collections. We continue to focus on offering our clients high design combined with the trademark comfort and functionality that define livable luxury aesthetic.

On the strategic investment front, as we've communicated, we are focused on setting the foundation for our long-term growth by improving operational efficiency with upgraded infrastructure, technology and processes. We are pleased to have implemented our new warehouse management system and continue to refine the opportunity for operational efficiencies.

Further, over the next several months we will begin to deploy a new planning system that will help optimize our inventory purchases and forecast capabilities, and a new ERP at our upholstery manufacturing facility that will improve margin visibility and production capabilities. We are continuing to work hard to create a future scalable operating environment that will set the stage for more efficient growth.

Turning now to supply chain for an update on ocean freight, all carriers are still avoiding the Red Sea, and transit times are two weeks longer, on average, which we are planning for in our inventory purchases. Spot rates have increased this summer from container capacity shortages, early peak-season shipping and port congestion at Asian points.

During the second quarter, we were able to bring in all of our containers using our contract rate, but have paid some higher spot rates in the third quarter to ensure product availability for our clients. This impact is factored into our revised outlook for the remainder of the year.

Together with our vendors, not only did we learn to successfully navigate supply chain challenges during the pandemic, but we confirmed our geographically diverse supply chain is an advantage in our industry. I'm pleased to say that with our strong vendor relationships, we are also working together to improve our costs, given the current environment. But don't mistake that for cost engineering. We do not reduce our quality to hit a margin target.

Before I turn this over to Dawn to discuss our results and outlook in more detail, I want to thank our teams for striving to provide industry-leading client service every day and for achieving key milestones in advancing our strategic growth initiatives in the first half of 2024. I'm extremely proud of all of you, and I'm excited to keep the momentum going.

Now I'll turn it over to Dawn.

**Dawn Phillipson**

Thank you and good morning.

Net revenue in the second quarter was \$310 million with a 7.1% comp decline. The decrease in net revenue compared to the prior year was driven primarily by the non-recurrence of prior year abnormal backlog deliveries and the implementation of our warehouse management system in our Ohio distribution centers. As John mentioned earlier, our demand comp declined 3% in the quarter with April's mid-single digit increase more than offset by mid-single-digit declines in the balance of the quarter.

Our second quarter gross margin decreased to \$124 million, driven primarily by higher Showroom costs as we continue to expand our footprint, lower product margin related to promotional activity, and increased delivery and transportation costs as we continue to invest in our final mile experience.

Gross margin as a percent of net revenue decreased to 40.1%, driven primarily by lower product margin, higher Showroom costs 160 basis points, and higher delivery and transportation costs.

Second quarter SG&A expense increased \$9 million to \$95 million, primarily driven by higher selling expenses related to new Showrooms, increased corporate expenses as we invest in our strategic initiatives to support and drive the growth of the business, and higher warehouse expense related to increased productivity in Dallas and the WMS implementation.

Second quarter 2024 net income was \$22 million.

Adjusted EBITDA in the quarter was \$40 million versus \$64 million in the second quarter of 2023.

Second quarter net revenue of \$310 million and Adjusted EBITDA of \$40 million resulted in a 12.9% Adjusted EBITDA margin in the quarter.

As we reported this morning, we are lowering our full year outlook for 2024.

While our first half performance was consistent with our expectation, our second half net revenue and gross margin expectations have changed given recent demand trends.

We experienced softening demand comps starting in May and the negative trend accelerated into July. We believe this is a reflection of a pull-back by the home furnishings consumer that is starting to impact our business. In the past, we've seen that our client has typically been the last to stop shopping and the first to start again during time of economic downturn. Similar to how we've handled other cycles, our uncompromising strategy of new product introductions, marketing investments, and opening new Showrooms will allow us to capture market share as the macro improves and as clients return to investing in their homes.

Our outlook contemplates a low double-digit demand comp decline for the remainder of the year. We believe this is especially prudent in an election year when the industry generally experiences slowing year-over-year sales growth in the second half of the year relative to the first half. At the same time, as John mentioned, we are very excited about our fall product launches supported by robust marketing campaigns.

As the midpoint of our range implies, we expect net revenue to decline approximately 1% in the second half of the year versus the second half of 2023. On the profitability side, we expect approximately 280 basis points of Adjusted EBITDA deleverage in the second half of 2024. We expect about 70% of the deleverage

to come from SG&A, with the balance in gross margin. The majority of this deleverage is from slowing demand and continued important growth investments.

Compared to our prior expectations for the second half, we now expect incremental deleverage from the lower net revenue, which will impact both gross margin and SG&A. Our outlook allows for flexibility around promotions of the balance of the year, as well as factors in elevated freight costs. We now expect gross margin deleverage in the second half of the year versus our prior expectation of gross margin inflection.

In the third quarter of 2024, we anticipate net revenue in the range of \$325 million to \$345 million, and at the midpoint we expect Adjusted EBITDA to decline approximately 130 basis points versus prior year.

For all other details related to our 2024 outlook, please refer to our press release.

In closing, I want to reiterate our strong commitment to our strategic growth strategy despite the current macro challenges. Our long-term growth targets have not changed. We continue to expect long term total revenue growth in the high single digits as we grow Showrooms in the mid to high single-digit range and comparable sales grow mid-single digits. We will also continue to improve operational efficiency, driving Adjusted EBITDA growth of low double digits long term.

Our debt-free balance sheet is a meaningful competitive advantage that allows us to make the responsible investments to build on our share gains in the highly fragmented \$100 billion premium home furniture market. We continue to navigate the current environment from a position of strength, and we believe we are well positioned to maintain our client-first service and drive value for all stakeholders.

This concludes our prepared remarks. With that, I'd like to thank you for joining us this morning, and we are happy to take your questions.

### **Operator**

Ladies and gentlemen, we will now be conducting the question-and-answer session. If you would like to ask a question, please press star and one on your telephone keypad. A confirmation tone will indicate your line is in the questions queue. You may press star and two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

Ladies and gentlemen, we request you to restrict to one question and one follow-up question.

Our first question comes from the line of Simeon Gutman with Morgan Stanley. Please go ahead.

### **Simeon Gutman**

Hi everyone. I wanted to ask first just a technical on the fourth quarter backing into the comp. It looks like it's down mid teens. It's just straight math but I want to make sure that's correct.

Then, the summer swoon I guess that's occurred, can you talk about has it been a real change in demand? Has it been, I guess, customers may be deferring purchases? Anything you can talk about product categories? Was it outdoor that slowed, or it's all the indoor and fall purchases that customers have stopped buying?

### **John Reed**

Good morning, Simeon. John Reed here.

First of all, the last part of that question, we've seen the products—it hasn't been a specific category whatsoever. It's kind of just been across the board. We're seeing nice traffic in our stores. People are just taking a little break right now from buying as much as they had been. Our business has been so strong for so long and we're still growing leads. Our interior designers are still very, very busy. So there really hasn't been a huge change in that; it's just it seems like the summer blues and people are traveling so much—our customers are certainly—that they're taking a little break from what they had been.

### **Simeon Gutman**

Then, if I can sneak in a follow-up, I think the press release mentions promotional activity. It may be the first time it's been written. Might have talked about it on calls, but talk about the backdrop and then your approach to it and how much you're wading in in the fall. You have new product coming. How much of the gross margin is also promotions for the back half? Thank you.

### **John Reed**

Sure, I can take part of that and Jen can as well.

The back half, our product lineup is unbelievable. We're very, very excited about it. We think it's certainly the strongest in the industry. I've been through these times—we all have—for quite a while, ups and downs and so forth, and the way our strategic plan has always been is people pull back in times like this if their business is bad. We kind of do the opposite; we accelerate our new product, our excitement, the looks in the stores, refreshing them up. We're bringing a lot of color in the stores. We're doing things that really excite the customer because that's what they want. They want exciting products. They want exciting visits, experiences, and if we keep that going people come back and we really win when business comes back. We've done that every time for 36 years now.

Jen, do you have anything to add to that?

### **Jen Porter**

Yes. Hi Simeon. Just add a little bit more color to that. As you heard, we did get more promotional in Q2 than what we've been in the past. As we've been speaking the last, probably almost two years now, we've definitely seen that heightened promotional activity out there from our peers.

I think of one of the really interesting things is we have a really tough macro environment out there for the last year, year and a half. We've been hearing a lot of our peers really having to address that and we have really been an outlier to that. So it's definitely something we've been monitoring. We're going to be continuing to monitor.

As Dawn mentioned, the guide for the rest of the year allows us to be promotional as we see what happens going into fall and Q4. But just echoing what John said, we are really, really excited looking at our fall launch coming here in just a few weeks. A couple of weeks back at the end of July, we did a sneak preview of some of our fall products and we're really pleased with the marketing engagement that we saw from consumers there.

We're seeing some positive elements. We're seeing really nice traffic to the website. We're seeing engagement with marketing. We're excited about the products. We're definitely seeing the lower traffic in stores, the lower order values in stores than we'd like. We saw that softening in Q2. We were also up against really positive strong comps last year in May and June, so we're looking at that acceleration that declined into July quite a bit. But there's a lot of positive coming forward to fall and as Dawn mentioned, we



are ready and able to be more promotional if we need to be, but we are also looking at all those levers we can pull in terms of increasing our marketing spend, making sure the fall product gets out to stores, continuing to open up our Showrooms, and really positioning us to be there when this cycle turns around.

**Dawn Phillipson**

Good morning, Simeon. This is Dawn.

I just wanted to confirm, you're thinking about that correctly from a comp basis in the fourth quarter down that kind of mid-teens is appropriate.

Then, with regard to your gross margin question in the second half, if you remember, we're lapping the price action SKUs from last year, so as we think about product margin year-over-year in the second half, there's a little bit of incremental compression layered into the second half relative to last year's second half, driven by some of those container costs that we are seeing elevate. But for the most part, from a product margin perspective year-over-year we think it will be relatively flat.

Then from a gross margin perspective, we are anticipating a bit of deleverage on Showroom rent versus last year as you think about the continued investment in new Showrooms and our growth strategy there.

**Simeon Gutman**

Thanks, Dawn. Good luck everyone.

**Dawn Phillipson**

Thank you.

**John Reed**

Thank you.

**Operator**

Thank you. Our next question is from the line of Max Rakhlenko with TD Cowen. Please go ahead.

**Max Rakhlenko**

Great. Thanks a lot, guys.

First, John, given your perspective, how long do these cycles typically last on the high end? Are they shorter than the overall market? Then, what categories typically inflect first as we do look for signs of improvements ahead?

**John Reed**

Good morning, Max.

Every cycle is different. We had the Big Crash. What was that? In '08 or something, which is totally different than COVID, which is totally different than today. So, your guess is as good as mine on that. Obviously there's a lot of news out there. There's an election coming up, which has all kinds of cheery news in it. So, who knows? I don't know.

I do know that we stay focused on what our plan is. We execute our plan very, very well; we think better than anyone. And we come out of these things—some of our competition may fall off and we come out of these stronger and get more and more market share every time. So, that's what we're focusing on and that's what we're excited about.

**Max Rakhlenko**

Got it. Okay. Then, philosophically, how nimble are you with dealing with changing competition in the marketplace? For instance, if close-in peers start to make changes on price that are impacting you, how would you go about maybe reacting, or is that generally not how you're thinking about the business?

**John Reed**

Generally not. We certainly watch the competition very closely, but when we compare product to product, we really don't have any product that we can compare to as far as quality goes or design goes. So, you know, we think the ones we do look at, if people are undercutting us the quality isn't there. It's inferior. So, we're not too worried about that. We've got an incredible sales team, the best in the business. Incredible army of interior designers who are out there and customers aren't—they want a beautiful home. They don't remember two years ago what they paid for it as long as it's working, it's comfortable, it's not falling apart and so forth. So we stay with that vision and that focus, that we're not going to compromise our quality.

We could easily cut quality and take prices down 20%, 30%, but I won't do that. I will not take quality down because in the long run that goes back to hurt you.

**Max Rakhlenko**

Great. Thanks a lot and best regards.

**John Reed**

Thank you.

**Operator**

Thank you. Our next question is from the line of Steven Forbes of Guggenheim Securities. Please go ahead.

**Steve Forbes**

Good morning. Maybe start with Dawn as a follow-up to Simeon's question. You think through the sort of decremental at the margin profile implied by the guidance change, it's really high and I think that's what we're trying to get our arms around.

You mentioned promotional activity. You also mentioned freight costs, right? Investments in marketing. Any way to help frame sort of how to explain the high decremental margin profile? Then, as you think through sort of this promotional activity comment, can you parse it out into the various impacts? How much is being driven by inventory management? Is there any sort of price value correction, and/or is this simply just to stimulate conversion given the macro? Thank you.

**Dawn Phillipson**

Good morning, Steve. As we're thinking about the second half, we are expecting deleverage of about 280 basis points versus prior year, so you can think about that as about 70% of that is coming through in SG&A and about 30% of that is coming through in gross margin.

On the gross margin side, as we said, we've left ourselves operating flexibility around promotions, but we're still feeling good about our product margin relative to prior year. We are seeing deleverage as we're continuing to invest in our growth strategies, which those new Showroom rents are rolling through gross margin.

So, the balance is in SG&A and, really, our spend as we think about what we guided to three, six months ago versus where we're at today is still consistent. We are continuing to invest in new Showrooms. We're continuing to invest in our strategic growth initiatives around our planning system, our manufacturing ERP, our warehouse management system.

We are going a little bit deeper in marketing in the back half of this year. Really excited to continue to drive brand awareness, increase our spend in prospecting a bit for the September catalog which is going to be beautiful and really support the product launches that are rolling out the end of this month. Then, a bit of deleverage on the warehouse expansion in Dallas is continuing to ramp up in productivity.

So, I think from a spend perspective, we're consistent with what we said all along. There's just some noise as you think about how that match is all working relative to where we thought revenue would be for the year six months ago, versus where we think revenue will be this year, in the back half, now where we think it will be today.

**Steve Forbes**

Maybe a follow-up for John. You think about this sort of lean into share and being very optimistic, right, about sort of the strengthening of the position during a challenging backdrop. Product obviously a big focus there. Can you expand on the product pipeline? What are some of the product initiatives that you're excited about, whether it's assortment expansion, breadth, depth? What are you sort of leaning into? Any teases for the fall here or early thoughts on newness come the spring?

**John Reed**

Sure. I can talk big picture about that.

We are launching new product in every category, first of all. Very, very excited about the upholstery end of the business, which is the largest category we have, and it drives—when you think about it, it drives a lot of other purchases – rugs, lamps, end tables, so forth. So we've really focused on that part and we're rolling out some incredibly strong product, incredibly great designs, some of the most comfortable, best quality things I've ever seen in my lifetime. And were hitting both sides. We're pushing the envelope as far as on the high end, and we also have some really great kind of starting price point products that we feel will bring new clients in the door, and if people are looking to save a little bit of money or not spend quite as much then we have that covered. I think that's probably our most exciting part, that I think as we've got the entire gamut of upholstery and that includes chairs and sectionals and sofas and so on and so forth.

Again, that's how I've always seen the business drivers, especially when times do dip a little bit. That's usually how we come out really strong.

**Steve Forbes**

Thank you.

**John Reed**

Thank you.

**Operator**

Our next question comes from the line of Seth Sigman of Barclays. Please go ahead.

**Seth Sigman**

Great. Good morning everyone. If you go back and think about the drop-off you've seen in the business the last few months, I guess I'm trying to better understand just the consumer engagement. Any more perspective on how much of that drop-off is actual traffic versus maybe conversion and consumers pushing things out? Do you have a way to measure that? Just trying to think through is it just deferral that comes back at some point? Just help us frame that a little bit. Thank you.

**John Reed**

I can start that, Seth.

People are coming in; they're not as excited as they were two years ago when COVID was going on where they would take anything at any price and wait any length of time for it. They just seem to be busy with other things in their life right now. They're still engaged. They're still coming in. We haven't seen this huge, huge traffic drop. The new stores are doing fantastic. The response is unbelievable, especially out in California. We're going to just keep focusing on that.

I don't know if you guys have anything else to say.

**Dawn Phillipson**

Interestingly enough from a data perspective, we've really seen some mixed results around different components. Traffic on a comp basis decelerated in the second quarter. The number of orders over \$5,000 and \$10,000 were up versus last year, so still seeing some strength there. Number of transactions increased healthily versus last year, but the average order was down slightly. Units per transaction is up though, so the data is really mixed. It kind of speaks to what John saying. Folks are maybe coming in more often to look at things prior to making a transaction.

Jen, anything additional on the consumer?

**Jen Porter**

Yes. I think Dawn and John said it all. We're seeing a lot. I think we are really pleased with seeing those \$5,000 to \$10,000 and above orders performing really healthily, if you think about consumer behavior when they're buying furniture. And if you have bought a new home or if you are updating and doing a renovation, you have a timeframe and you have that drive to complete that purchase. But as both Dawn and John mentioned, we're seeing less of that sense of urgency to complete for maybe some of those less urgent purchases. They're browsing. They're exploring. As I mentioned, we're seeing that heightened traffic to the website. We're seeing that heightened engagement with the product. As we've always spoken about, we

know that's where a lot of our clients are doing their exploring. They're engaging with the website before they make that purchase.

There's definitely that interest level. We're just seeing less of that urgency to make the purchase today. And as with what we've all been saying, I think that's what we are all focused on. That is really at the core of our strategy. We want to be here for our clients wherever they are ready and continuing to present them all of the great product, the inspiration, the reasons that separate Arhaus apart from everybody else out there in the market, and then we'll be here when they're ready to convert.

### **Seth Sigman**

That's helpful. I guess just the follow-up there is thinking about Arhaus has been able to really navigate a very difficult environment the last couple of years, right? It's been tough out there and a lot of your peers have been seeing that for some time, so to some extent it's caught up to you now. I guess the question we're getting is why now?

I do think if you look at your business on a four- or five-year basis, you adjust for all the swings, it's actually much more stable than the big drop-off that you're talking to. But, anyway, I guess the real question is, what gives you confidence that it's not something more competitive that's changing? What gives you confidence in price points where they are today, that they don't need to be adjusted further? Just any more context. Thank you.

### **John Reed**

I think, as you mentioned, we were the first ones to kind of—the last ones I should say, to see this effect of sales slowing down and our competitors have seen it a lot earlier. All I can say is we're going to come out of it a lot quicker as well. We've always seen these things where we do start them later than our competitors, but we also come out of them a lot quicker because of what we do. We've got an amazing product. We're not—absolutely don't think this is competitors taking our business by any means whatsoever. We look at that backwards and forwards. We're in touch with our stores, our store managers, our top sales people literally every week and we've not heard a peep about that, one little bit.

### **Jen Porter**

I think the other thing that I would add on to there about confidence is we've never seen price be the driving factor of our purchases. What's interesting, looking at Q2 and particularly going into July, we're actually—although we were more aggressive with our promotional strategy, we're actually starting to see promos be a little bit less effective in driving traffic and conversion. I think what that speaks to of us is it's not price that's a factor. Our clients want what they want. They are able to pay for it. Obviously everybody likes a deal, but it's not a question of if they can get a better price point they'll make the purchase and if they can't they won't. As John mentioned, you can't find the same product at the same quality at other competitors. So it's not a pricing conversation.

We're continuously monitoring that, but I think that just speaks to the fact that we're seeing this slowdown across promo and non-promotional business as something more to the macro level.

### **Seth Sigman**

I got it. Thank you so much. Good luck.

**John Reed**

Thank you.

**Operator**

The next question is from the line of Robby Ohmes with Bank of America. Please go ahead.

**Robby Ohmes**

Good morning. Thanks for taking my questions. There's kind of two follow-ups here. The first question is you guys called out that you're pleased with the new Showroom performance and I was just curious, is new Showroom performance better than you would have expected relative to existing Showrooms in the way they've been performing the last couple of months?

Then the second question, just to follow-up on the promotional question, are there any sort of changes to the way Arhaus would be promotional historically? Are there any new things you guys are looking at that you can share with us, specifically for this environment? Thanks.

**John Reed**

Yes, the new Showrooms are performing very well. We're very excited. The traffic is in there. The response has been absolutely phenomenal, especially out in California where we've focused on opening some incredibly beautiful—most beautiful Showrooms we've ever done. The response is great.

If you compare them to other stores, we really come up with a solid conservative sales plan for new stores and we're very happy to see how their business is doing. So, it's not necessarily comparing them to a store in Cleveland, Ohio or Tampa, Florida or something like that because they're all totally different markets. Different sized stores and so forth.

**Jen Porter**

Then, to jump in, and if you'll allow me for a second, I just have to do a marketing plug. If you guys haven't visited [arhaus.com](http://arhaus.com) in August, I strongly encourage you to do so. We've recently launched a campaign celebrating our Showroom experience and it features a lot of incredible imagery from some of these new Showrooms that we've opened this year. It's absolutely—it's stunning but it's just something, it celebrates something that we're really proud of as a business as how incredible our Showroom experience is and how unique it is. So, if you haven't visited it, please go check it out.

But to touch on your point about just promotional strategy and how we're thinking about the rest of the year and if we're going to make any changes, as I mentioned earlier and Dawn mentioned, the guide does allow us that flexibility on how we're looking at promos for the rest of the year. We are currently looking at our same strategy, both Holiday weekend, Black Friday, those key promotional periods. We've been talking over the last few calls about how we've started lengthening those promotional periods. We're always looking at how we're setting those up, what those look like, how we are optimizing our marketing messaging of those promos, so we are going to continue to do that into the back half. But as of now, really looking at those similar time periods as our ongoing strategy.

**Robby Ohmes**

Terrific. Thank you.

**John Reed**

Thank you, Robby.

**Operator**

Thank you. Our next question is from the line of Phillip Blee with William Blair. Please go ahead.

**Sabrina**

Hi. This is Sabrina on. Thanks for taking our question. Can talk about some of the progress your team has made on the internal system investment and what benefits you expect to gain when the new system launches over the next few months? Maybe from inventory purchasing or your forecasting ability.

**Dawn Phillipson**

Morning, Sabrina. Yes, we're excited to continue to invest in the systems that we've been talking about. Our warehouse management system launched in April and we're continuing to refine that and build on some of the operating efficiencies that we have seen in the system to date. So, excited for how that's continuing to progress and as we continue to tweak that.

Our planning software is in process, as we've said before, and there's a couple of different unlocks in different phases that we'll have with that program. It's on track with where we expect it to be. So, you know, some great opportunities with that is improved demand forecasting at a more granular level both geographically and then on a SKU basis. So, really looking forward to getting some unlock there, driving some labor efficiencies with the teams here, and so over the next several months we'll be kind of launching the first phase of that.

Then our manufacturing ERP, which is going to provide quite a bit of increased margin visibility and production capability enhancements. That is also slated to launch over the next several months. As you can imagine lifting an entire ERP for a manufacturing facility is expensive and we want to make sure that we're doing it correctly, and really thinking through the different benefits and making sure that we are deploying that responsibly.

So, excited for all of those things to launch. No major delays or anything that I would call out here. So, yes, looking forward to getting those up and running for the team.

**Sabrina**

Thanks. That's helpful. Then quickly, back to the competitive landscape, have you been seeing a lift from the local independent mom and pops going out of business along with maybe other regional look brands in the premium space? Any thoughts there would be helpful. Thank you.

**John Reed**

I don't have any data on that. We're in so many different markets now, that's hard to see. I haven't seen anything locally here. You know, you would—that would be more local marketing and so forth and I'm not seeing anything here and I haven't heard anybody report on anything.

**Operator**

Sabrina?

**Sabrina**

Thank you.

**John Reed**

Thank you.

**Operator**

Our next question comes from the line of Peter Keith with Piper Sandler. Please go ahead.

**Peter Keith**

Thanks. Good morning. I'm going to take the competitor question with a different angle.

So you do have a large competitor in the space. It seems like they've tried to knock off some of your product lines. Maybe if you look at that direct overlap where you've been copied, are you seeing any impact on that area of your business in the last month or two?

**John Reed**

Good morning, Peter. To answer your question, no, we have not. We feel, again, our product is a great quality, incredible pricing and we have not seen any change in those particular products that you may be referring to.

**Peter Keith**

Okay. Good. Then maybe for Dawn, I'm just trying to play around with the model and wondering why there's such a large sales and comp drop-off in Q4. So, if I just take the midpoint of the Q3 comp guide, it seems to imply Q4 comp of a down 9 to a down 20 and Q4 revenues below Q3. Can you walk us through why that is the proper outlook?

**Dawn Phillipson**

Yes. Mostly it's timing, Peter. As you think about, if we are anticipating a kind of low double-digit demand comp decline, the timing to get that product delivered, there's just a bit of a lag. So, really, as you think about the timing of the demand to delivered realization. Then, also, just remember last year up against a really strong abnormal backlog. Every quarter as we progressed through last year we had a higher number of—a higher amount of abnormal backlog that we were delivering. So just the year-over-year compare is still skewed by that component.

**Peter Keith**

Okay. Thank you.

**Dawn Phillipson**

You're welcome.



**John Reed**

Thank you, Peter.

**Operator**

Our next question is from the line of Jeremy Hamblin with Craig-Hallum Capital Group. Please go ahead.

**Jeremy Hamblin**

Thanks. I want to come back to the commentary around gross margin. I think, Dawn, that you noted that in the back half of the year you expect some deleverage. I was hoping you might be able to provide a bit more kind of guardrails around what you're expecting kind of Q3 deleverage versus Q4.

**Dawn Phillipson**

Yes, absolutely. I think the important thing to note is that there's—the reasons are the same. As we think about the third quarter and we think about the fourth quarter, continuing to invest in new Showroom expansions, continuing to invest in our strategic investments. There isn't necessarily a significant spike in one quarter versus another as we think about the back half, so to the extent that is helpful.

I would just note, continue to note that last year we would have been getting incremental deleverage—sorry, incremental leverage last year from the higher abnormal backlogs as we move through the year. So when you're looking on a margin rate basis in the quarter, just keep in mind that there might be incremental deleverage in the fourth quarter relative to the third, just driven by the abnormal backlog of last year.

Then as we think about the price action SKUs that we were deploying in June of last year and as those were getting delivered, deliveries of those would have been heavier in the fourth quarter versus the third quarter. So, just a little bit of noise there, I would say, between the quarters on timing of deliveries versus when we deployed those price actions.

**Jeremy Hamblin**

Got it. Okay. Then I just want to come back to the traffic trends and conversion here for a second, because I think there was a little bit of mixed messaging in terms of—it sounds like traffic is down, and wanted to get a sense if you could share how much traffic has fallen off May, June, July, just to get a sense for what you're seeing from conversion and kind of those that are more or less window shopping but not purchasing in the near term.

**Jen Porter**

Interestingly enough, traffic was down more year-over-year in the first quarter than in the second quarter, so while traffic on a comp basis was still down in the second quarter it was sequentially up. So, interesting, I'd call it in kind of the mid single digit decline for the second quarter.

**Jeremy Hamblin**

And what about as you've started in Q3?

**Jen Porter**

We haven't disclosed that. We're seeing, I would say nothing—no meaningful change in metrics, but recognize that one month doesn't make a quarter either. We're tracking it. We're paying very close attention to the demand metrics. We look at those on a daily basis to see what's happening in each Showroom, but we'll report more on that when we report the third quarter.

**Jeremy Hamblin**

Got it. Thanks for the color. Best wishes.

**John Reed**

Thank you.

**Operator**

Our next question is from the line of Cristina Fernandez with Telsey Advisory Group. Please go ahead.

**Cristina Fernandez**

Thank you. Good morning. I wanted to ask about inventory flow and as you look at the demand trends you've seen the past few months, what is your flexibility in adjusting your inventory to remain in a clean position here over the next 6 to 12 months?

**John Reed**

Again, we've been through many, many cycles, up cycles where we need our partners to make more product, and if we're having a down cycle then we ask them to make less product. So, it's fairly straightforward. We're very, very flexible. We're incredibly meaningful to our suppliers and they're our partners, so they work with us both ways. Ideally, everything is perfect and everything—they can make exactly the same amount of pieces every single month, but that just isn't reality. They're very flexible. We don't see any issues with that. If we get in an overstock position or an understock position we work with them to fix it and level it out.

We've got a great planning team and a great sourcing team and a great product team that are very, very close to the vendors and they do whatever they can in their power to help us out with smoothing out inventory.

**Cristina Fernandez**

Then the second question is going back to the promotions, it seems like you increased promotions in the second quarter and are willing to step them up. How are you balancing making sure that you don't damage the brand or train the consumer to wait for the promotions, especially if the promotions are not being as effective in driving traffic and conversion?

**Jen Porter**

Good morning, Cristina. That's a great question and that's at the heart of what we talk about and focus on every single day here.

I think the way we are approaching that and the way we've always approached that is we right now are looking forward to our fall launch. We're looking forward to the fall product. We're looking forward to the fall marketing.

There are two reasons why we increased the investment in our fall marketing campaign. One was to offset what we are starting to see in the macro, but the other is because we love the campaign and the product that we're launching so much. Truly believe it is the best catalog that we have ever put out into the market and we have great, great product that we're really proud of as well.

I think to your point, it really is having those conversations and balancing, and making sure that we don't lose sight of our long-term opportunity with any short-term decisions or needs that we're making.

I think on the flip side though, we have proven over the last four to five years now that by speaking to and emphasizing the product assortment, the quality, the artisan story, the differentiation, the Showroom experience, and everything that we do and the majority of the marketing and messaging that we put out there, it allows us to be promotional when we want to be without damaging the brand as you mentioned. That is a balance, that is something we want to do, but our clients are very smart. They know what they want. They know how the markets work. They know how promotions work, and so we're constantly, constantly towing that line, and that's our strategy going into the back half of the year. We're not going to overreact any which way. We're going to keep doing what works for us and what we do best. We'll be reading our fall launch very closely here in the next two months.

**Cristina Fernandez**

Thanks.

**John Reed**

Thank you.

**Operator**

Ladies and gentlemen, if you wish to ask a question, please press star and one.

Our next question is from the line of Peter Benedict with Baird. Please go ahead.

**Peter Benedict**

Hey, good morning, guys. I was a little late to join so I apologize if either of these have been asked.

My first question is just could you clarify the revenue headwind from the warehouse management system implementation that went in April?

**Dawn Phillipson**

Yes. Good morning, Peter. Certainly, there was a little bit of an impact which we had talked about on prior calls. Just from a timing perspective, about one week, call it, of revenue that was shifted into a different time period.

**Peter Benedict**

Okay. Thanks. Then given the investments you're making in stores and systems, just curious what level of revenue growth you think would be required to kind of hold your EBITDA margins flattish. Obviously in the back half of this year you guys are pushing ahead with the investments. Kind of as a related question, as you think maybe more towards 2025, if a soft demand environment persists, do you continue on that path or do you make any adjustments to try to cushion the margin impact? Thank you.

**Dawn Phillipson**

Yes, so I would say there's kind of two things that I would call out in response to your question. The first is that we firmly and strongly believe that continuing to invest in Showroom expansion, new product introductions and our marketing campaigns are incredibly important, even in a down cycle. So as we think about the investments in the organization, to come out of a down cycle in a very strong position and take market share, continue to build on our market share gains, we need to continue to invest in those three components in particular. So, we will continue to do that.

As I think about your broader question, we are still in growth investment mode, so as you think about the investments we're making in the back office, we've talked about our warehouse management system, we've talked about the planning system, our manufacturing ERP. We've also been assessing over the last several months what other system changes need to be deployed in order to support the size of the organization today and then drive future efficiencies as we continue to scale top line.

I would say near-term investments are going to drive that longer-term margin expansion, but in the near term we need to be thinking about that. I would encourage you to think about it in that there is going to be additional investment. We've said we're investing \$10 million to \$15 million this year in our corporate strategic investments. You could anticipate that number will be comparable next year, if not a little bit higher, and we'll give more detail and insight into that as we continue to refine internally and confirm our timing plans on those.

The other item that I would just call out as a reminder is that on the incremental flow-through of revenue, flow-through down to Adjusted EBITDA is between 30% and 40%, so if that's helpful as you're kind of building out your models, that's the flow-through.

**Peter Benedict**

Great. Thanks so much, Dawn. Appreciate it.

**Dawn Phillipson**

Thanks, Peter.

**Operator**

Thank you. Our next question is from the line of Jonathan Matuszewski with Jefferies. Please go ahead.

**Jonathan Matuszewski**

Hey, good morning. Thanks for taking my question. I wanted to ask about the typical consumer purchase cycle. I'm sure it varies, but is there a standard decision lens that you observe between maybe an initial visit to the website or initial visit to the Showroom and maybe when that consumer decides to pull the trigger on a purchase? Just trying to think about whether this is a dynamic where consumers are just being more

choiceful and maybe just need more time to make a decision, so maybe you'll see kind of that demand flow through later in the year. Any perspective on that kind of decision process and any kind of changes you've been observing lately? Thanks so much.

**John Reed**

I can start that, Jonathan, and then Jen can jump in.

In the store model, typically folks come in a store, they touch/feel things, they go back, they take swatches home, things like that and they figure out what they want and need. Then if they need more help, we could put them together with one of our interior designers. They can come—certainly they come back at least twice before they buy as an average. Certainly there's people who walk in and say, "Hey, I need a sofa tomorrow," and they buy it and we deliver it in five days or so. But most people are more thoughtful. They have to measure. They're not experts at that, seeing what colors go together, what rug goes with what fabric on the sofa, things like that. So it's a longer process. Sometimes they'll come back twice, sometimes three times. Sometimes four times, depending on the project and depending on how much they love—you know, a lot of people love this process. They're fixing up their home to be beautiful and it's a really, really important decision for them, so they take it seriously. Sometimes they buy a little quicker than other times. Right now, they're buying a little slower than normal, but that's kind of the process.

Jen can fill you in on the rest.

**Jen Porter**

Yes. Hi Jonathan. Totally agree with everything John just said and I think that's what we really look at. Furniture is a considered purchase. You definitely see differing behaviors. We definitely see people who walk in and buy a chair or go to the website and buy décor or soft goods or accessories, but our clients we believe are attracted to Arhaus because of the quality, because of the ability to really consider and build out a home for your family for years to come. Our furniture is built to last. These aren't just purchases that people are making and then looking to re-do six months later. So I think it's really interesting when you look at the spectrum of those behaviors.

One thing I think that's also interesting to remember as you think about Arhaus versus some of our peers in the space as well is to remember that we are more heavily weighted to those larger furniture pieces, those larger average order values. I think that does play around a little bit with the mix of how effective things like promotions are or how effective those things in terms of trying to drive that sort of spur of the moment impulse purchase. We do see great success with that, with people going online. But really, it is about allowing and providing that space and that experience for clients truly to take their time and to be inspired and build a home that they can really be proud of.

**Jonathan Matuszewski**

Helpful. Thank you.

**Operator**

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

**Peter Keith**

Thanks for letting me back in. Two follow-ups. The first one is for John.

You've been in this business for quite a number of decades. Have you had a period where you had one or two soft months that were just a hiccup and then the business retraced back to normal trends? Does this seem like a familiar backdrop that you've seen before, or this pace of slowdown is a bit unprecedented?

**John Reed**

I have, Peter. This has happened before and it seems like it's a hiccup. Typically it happens in the summer months where folks are focusing on other things. They're outdoors. They're traveling, trying to get all the vacations in with their kids and so forth. It's not untypical.

We haven't seen it lately because of COVID and so forth, so we were all spoiled on seeing double-digit increases every month. But no, I absolutely have seen it in the past, for sure. Then it comes back—in the past, typically it has come back pretty strong in the fall when people are back in their homes and getting ready for the holidays and so forth.

**Peter Keith**

That's kind of good for my final question to Dawn. You've had a really tough July. I don't think of July as a seasonally relevant month for furniture, to your point at the vacation months. So with the construct of the guidance, you've taken the EBITDA down 30% for the year. Are you taking—I guess help us understand is stack demand trends coming out of July, you're kind of holding that? And then on the gross margin, it sounds like you've also given yourself some wiggle room to promote but there could be upside if you don't promote. Just trying to understand the magnitude of this guide down after one soft summer month.

**Dawn Phillipson**

Yes. I'd clarify a little bit, we have seen deceleration in the May/June timeframe that was stronger deceleration than what we would have anticipated in those months. Certainly accelerated into July. So while the second quarter demand comp was down 3%, we've had about 90 days, three months of deceleration. And so, I think it's prudent as we look towards the back half of the year, there's a lot going on with the economy. There's a lot going on with the election, which can be very distracting.

Certainly, I don't have a crystal ball. I don't know exactly how to balance that this year is going to play out. I think this is a responsible way to think about the business, think about the trends that we're seeing, think about—we have a lot of additional customer information that we don't share publicly for competitive reasons, and those indicators are kind of telling us that maybe this could persist a little bit longer than just July and August.

I think this is a responsible way to look at the business through the back half. We think that there's a nice opportunity and wanted to leave ourselves wiggle room in the number for promotional activity as we move through the year. In a great environment, in a perfect world we won't need it and the consumer will return very strongly in a couple of months. But we don't have any evidence that that is going to be the case, so we're just prudently managing as we're thinking about the business, watching the consumer trends on a daily basis and I think this is a reasonable expectation for the organization at this time.

**Peter Keith**

Okay. Maybe just one very quick follow-up. July is a quirky month for a lot of companies. We're finding the earnings season get hurricane, CrowdStrike outage. Anything in that sort that may have impacted the demand comp that you'd want to flag?

**John Reed**

Not that we've seen. No. Nothing we can put our fingers on, Peter.

**Peter Keith**

Okay. All right. Thank you very much.

**John Reed**

Thank you.

**Operator**

Thank you. Ladies and gentlemen, this concludes our question-and-answer session. I would now hand the conference over to Wendy Watson for her closing comments.

**Wendy Watson**

Thank you everybody for joining today. We will look forward to talking to you again next quarter.

**Operator**

Thank you. The conference of Arhaus has now concluded. Thank you for your participation. You may now disconnect your line.