

**XELB / Nasdaq**

**SPECULATIVE  
BUY**

Initial

**\$4.80**

**Target**

**CAPITALIZATION**

Shares Outstanding (11/8/22)	19.62 M
Recent Price (11/25/22)	\$0.84

Market Capitalization	\$16.48 M
+ Debt	-0- M
- Cash	<u>8.41 M</u>
Enterprise Value	\$ 8.07 M

Book Value	\$76.46 M
Working Capital	\$11.44 M
Dividend	Nil

Balance sheet figures as of 9/30/22

**MARKET DATA**

Bid-Ask Spread, % Price	4.6%
52 Week High/Low	\$1.99 - \$0.80

Shares Outstanding	19.62 M
Inside Ownership	56%
Institutional Ownership	20%
Estimated Flotation	5.20 M

Average Daily Volume	12 K
Short Interest, % of Float	0.24%
Beta	1.46

Source: Bloomberg LP

**INVESTMENT RETURNS**

	XELB	Sector
Return on Equity	neg	-7.27%
Return on Assets	neg	-1.90%
Return on Capital	neg	-3.24%

Source: Crystal Equity Research, CSI Markets

**FINANCIAL PROFILE**

	FY20	FY21
Sales	\$29.45 M	\$37.93 M
(L)EBITDA	2.20	(4.35)
(L)EPS	(\$0.68)	(\$0.63)

Source: Company Reports

**HIGHLIGHTS**

- **Acquisition cash kitty.** Xcel Brands ended the quarter with \$8.4 million in cash after using \$2.3 million to support operations in the quarter ending September 2022.
- **Growth strategy.** Undeterred by a challenging macro-economic environment, Xcel leadership is executing on plans to build out its *C. Wonder* and *Halston* plans, news of which should serve as strong catalysts for investor interest.
- **Media platform.** The new creative director for *C. Wonder* has already stepped into Xcel's live stream programming. The platform distinguishes the Company with consumers and could impress potential brand owners considering a deal with Xcel.
- **Undervalued.** The precedent transaction valuation method suggests the stock has a current intrinsic value of \$4.80 per share.
- **Stock price catalyts.** New interest in the stock could be triggered by quarter reports with evidence of building revenue and improving margins. As noted above, news is expected of the *C. Wonder* brand relaunch and availability of the *Halston* brand in U.K. distribution channels.

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INDUSTRY: Consumer Cyclical, Apparel

XELB: NASDAQ

## RECENT DEVELOPMENTS

Earlier this month Xcel Brands reported financial results for the third quarter ending September 2022, the first full quarter that financial results reflected the new minority ownership in *Mizrahi* brand. Shareholders had already seen a deleverage balance sheet and the use of cash proceeds from the sale of the majority interest in the highly successful *Mizrahi* brand. Sales came in at \$4.5 million, lower than our admittedly aggressive target of \$6.1 million. We were not surprised by the reported loss on the quarter of \$4.0 million. More important in our view given management's growth strategy is that a significantly lower figure of \$2.3 million in cash was required to support operations.

We are undeterred in our interest in the Xcel strategy to buy and build strong apparel and footwear brands. We may not have pegged the third quarter, but we remain confident in management's growth strategy to deliver value to shareholders. Xcel is vertically integrated through most of the fashion pipeline - design, sourcing, retail relationships, and direct sales to consumers. Importantly, management has crafted a sophisticated distribution strategy featuring live streaming to reach consumers. The Company is well distinguished in the industry by its production knowhow and media relationships with television shopping networks. We believe Xcel Brands presents an attractive partner for up-and-coming designers who need an ally to navigate the thornier challenges in the fashion value chain. This bodes well for successful acquisitions to expand Xcel's brand portfolio.

## RECOMMENDATION

Based on our precedent transaction analysis, XELB is trading at a steep discount to intrinsic value. Some of the discount might be linked to limited liquidity given significant insider ownership. Lack of market visibility could also be a factor. In our view, the current price level does not reflect Xcel's successful track record in building consumer brands, its pristine balance sheet for executing on an acquisition strategy, or the superior growth potential in its media-focused distribution scheme.

We reiterate our Speculative Buy rating on XELB and maintain a near-term price target of \$4.80, which coincides with our estimate of intrinsic value. Key catalysts for the shares include 1) further evidence of building revenue and returns through the revised minority position the *Mizrahi* brand, 2) new awareness of the benefits of a deleverage balance sheet that eliminates interest expense and reduced risk for the stock, 3) progress on brand projects including the relaunch of the *C. Wonder* brand and new distribution arrangements in the U.K. for *Halston*, and 4) new projects such as the *Q-Optics* product line through the HSN and QVC shopping networks. We also note management's concerted efforts to gain new visibility for XELB among investors.

## VALUATION

Price/Sales	0.56 X
Price/Cash Flow	neg
Price/EPS	neg
Price/Book Value	0.21 X
Consensus EPS 2022	na
Forward PE	na

## OPERATING PROJECTIONS

US\$	2020A	2021A	2022E	2023E
Sales	\$29.45 M	\$37.93 M	\$ 27.22 M	\$ 30.50 M
Operating (Loss)	(16.46)	(12.56)	(18.67)	(9.50)
CFO (U)	3.19	( 6.56)	(11.33)	(1.32)
EPS (LPS)	(\$0.68)	(\$0.63)	(\$0.04)	\$(0.34)

Dollars in millions except per share earnings

Per share figures estimated 9/30/22

Company Reports and Crystal Equity Research Estimates

## RECENT DEVELOPMENTS

Xcel Brands tapped an American designer, Christian Siriano, as creative director for the *C. Wonder* brand. The Company is planning a relaunch of *C. Wonder* in March 2023, including livestreaming on the Home Shopping Network. Siriano has already jumped into the role public persona of the ready-to-wear apparel and accessories, appearing on livestream shopping programs. Siriano's experience in promoting his own branded designs makes him particularly well qualified to front the *C. Wonder* name. In 2007, he became the youngest winner of the American designed competition television show *Project Runway*.

The Company launched its new *Q-Optics* project on both the Home Shopping Network and QVC Television Network. Xcel leadership has emphasized the financial strength of this joint venture as the arrangement allows the Company to leverage its partner's inventory. We believe this means Xcel will have minimal working capital obligations to initiate the new revenue stream, a circumstance that bodes well for returns on investment.

## QUARTER REPORT

The Company reported total sales of \$27.2 million in the quarter ending September 2022, composed of \$2.2 million in license fees from Xcel's various brands and \$2.3 million from product sales. The period represented Xcel Brands' first full quarter without minority ownership of the Mizrahi brand. Income from the retained 30% share in Mizrahi is now reported as other income. In this quarter the Company reported a net loss of \$277,000 in the ownership position. The quarter ended with a net loss of \$4.0 million or \$0.21 per share.

Cash earnings in the quarter after adjustments for non-cash expenses and charges was a loss of \$3.3 million or \$0.17 per share. We note the Company used \$2.3 million of cash resources to support operations in the quarter. In our view, the latter figure is the more valuable in determining the Company's financial health.

The quarter provided shareholders with a full view of Xcel Brands' profile since the strategic move to monetize the Company's equity in the Mizrahi brand and the de-leveraging of the balance sheet. We note that sales were lower and expenses higher than had been projected, which was, in our view, less a matter of the Company coming up short as it was the challenge of pegging the mix of the changing business model and the twin impacts of inflation on demand and costs. During the earnings conference call management described decreased wholesale activity in both apparel and jewelry lines as retailers continue to rationalize inventory levels. Unexpectedly, the Company lost orders during the quarter due to supply chain disruptions as certain overseas factories were closed due to fresh outbreaks of the COVID-19 virus.

In our view, balance sheet strength is another key takeaway from the quarter report. The Company held \$8.4 million in the bank at the end of September 2022, providing a good purse to execute on management's brand acquisition plans. Working capital was \$11.4 million.

## REVISED MODEL

Our model has been updated to reflect the third quarter financial results. We moderated our sales estimate for the fourth quarter 2022, as our estimates in the near-term were admittedly aggressive. Nonetheless, our model is still in meant to illustrate our confidence in the Company's strategy to build sales of its existing brands through its live streaming connection to discerning customers.

- We suspect neither supply chain issues nor inventory rebalancing issues have been fully worked out and could cut into performance yet again in the December quarter.
- Our sales estimate for the year 2023, have been left unchanged as we have considerable confidence in the ability of the Company to bring new vigor to the topline with new sales channels in the United Kingdom. A premium line under the *Halston* name is on schedule for launch in Spring 2023.
- Although we have not included it in our sales estimates as yet, the Q-Optics joint venture with the shopping networks could also contribute to the year 2023.
- Management has also teased additional projects with the television shopping networks. These initiatives may seem ill advised given current economic pressures on consumer spending. In our view, the efforts are well timed as there is already evidence that central bank policies to combat inflation are working. The Company needs to be ready when the economy resumes growth.

Additionally, we made adjustments to our costs and operating expenses rates, using the third quarter results as a guide.

- While we observe attempts by senior leadership to keep tight control of spending, we note that there are plans afoot to launch new marketing and sales campaigns. The Company has hired new design professionals to lead the *C.Wonder* and *Halston* brands. A new multi-branded site is planned for an early 2023 launch. These undertakings could add to costs in the coming quarters, at least temporarily deepening losses until the investment pay off.
- We expect profit margins to get a boost beginning in early 2023, through a shift in apparel importation patterns and other operational efficiencies. During the earnings conference call, management indicated its Mexico warehouse facilities are on schedule for completion by the end of the year 2022, making it possible to take advantage of preferential duty treatment on imports of apparel goods from Mexico. Additionally, the Mexico facility will result in more efficient logistics and inventory management. The shift to a Mexico importation source is expected positively impact profit margins beginning in early 2023. During the quarter earnings conference call, management suggested overall operating costs could be reduced by \$2.5 million per year.

The combined impact of the adjustments to our model is a deeper loss in the year 2022, and an increase in cash usage by operations. The revised estimates are shown in summary in Table I below and in more detail in Table II on the following page.

**Table I: Summary Historical and Projected Sales and Earnings**

	2020 Actual	2021 Actual	2022 Estimate	2023 Estimate
Sales	\$29.45 M	\$37.93 M	\$27.22 M	\$ 30.50 M
Gross profit, total	23.99	27.27	19.85	22.88
Gross Margin %	81.5%	71.9%	72.9%	75.0%
Operating income (loss)	(16.46)	(12.56)	(18.67)	(9.50)
Earnings (loss) per share	(\$0.68)	(\$0.63)	(\$0.04)	(\$0.34)
Cash flow used by operations	\$ 3.19 M	(\$ 6.56) M	(\$ 11.33) M	(\$1.32) M

Source: Company Reports and Crystal Equity Research Estimates

## VALUATION AND OUTLOOK

We reiterate our Speculative Buy rating of XELB. We remain confident in the overall strategic plan to monetize the success Xcel Brand's achieved with the *Mizrahi* brand and to invest in new fresh brands and opportunities. The team has been fortified with new design talent who are particularly well qualified to help execute on Xcel's leading edge live streams to reach consumers. The Company has also invested in new supply and distribution infrastructure that will ultimately contribute to operating efficiencies. In our view, the Company is poised for top-line growth and profit expansion.

Our price target of \$4.80 is also maintained. We used a particular precedent transaction - the purchase of majority interest in the *Mizrahi* brand - as a guide for valuing XELB. The analysis resulted in an intrinsic value of \$4.80 per share, after adjusting for liquidity and control premiums. In our view, the precedent transaction is a credible valuation method given the incorporation of recent industry trends as well as the impact of macro-economic developments on sales and profits.

In our view, the stock remains deeply undervalued against its balance sheet strength, strategic growth plans and market opportunity. What will cause investors to reevaluate the Company's prospects? There are several developments expected in the first months of 2023, that should prove leadership is delivering on promises to build revenue. These include the *C. Wonder* relaunch and new distribution channels for it and *Halston*. Additionally, we expect the Company to announce its new multi-brand website in the coming months.

Table II: Historic and Projected Quarterly Sales and Earnings

Dollars in Thousands	2021				2021	2022				2022
	1Q	2Q	3Q	4Q	Year	1Q	2Q	3Q	4Q	Year
Net licensing revenue	4,307	6,224	6,854	4,491	21,876	5,961	5,175	2,166	2,500	15,802
Net product sales	3,502	4,540	4,407	3,607	16,056	2,786	3,292	2,335	3,000	11,413
Total revenue	7,809	10,764	11,261	8,098	37,932	8,747	8,467	4,501	5,500	27,215
Cost of product sales	1,835	3,063	2,865	2,904	10,667	1,680	2,570	1,465	1,650	7,365
Gross profit	5,974	7,701	8,396	5,194	27,265	7,067	5,897	3,036	3,850	19,850
Operating expenses:										
Salaries, benefits & taxes	4,052	4,049	4,185	4,249	16,535	4,853	5,236	3,301	3,575	16,965
Selling, general & administrative expenses	3,038	3,090	3,463	4,773	14,364	3,392	3,803	3,618	3,850	14,663
Depreciation and amortization	1,210	1,848	1,891	1,881	6,830	1,820	1,812	1,815	925	6,372
Other operating expenses	160	431	163	(34)	720	32	485	-	-	517
Asset impairment charges	-	-	-	1,372	1,372	-	-	-	-	-
Total operating expenses	8,460	9,418	9,702	12,241	39,821	10,097	6,293	8,734	8,350	38,517
Operating income (loss)	(2,486)	(1,717)	(1,306)	(7,047)	(12,556)	(3,030)	(1,445)	(5,698)	(4,500)	(18,667)
Other income (expense)										
Equity in earnings of unconsolidated affiliates					-	-	-	(277)	400	123
Interest expense	(280)	(522)	(565)	(549)	(1,916)	(708)	(1,187)	-	-	(1,187)
Loss on extinguishment of debt	-	(821)	-	(695)	(1,516)	-	(2,324)	-	-	(2,324)
Other, net	-	(100)	(23)	(24)	(147)	(1)	20,608	6	-	20,14
Total other income (expense)	(280)	(1,443)	(588)	(1,268)	(3,579)	(709)	17,897	(271)	400	17,226
Income (loss) before income taxes	(2,766)	(3,160)	(1,894)	(8,315)	(16,135)	(3,739)	6,265	(5,969)	(4,100)	(1,441)
Provision for income taxes (benefit from)	138	(1,346)	(535)	(1,087)	(3,106)	-	3,178	(1,539)	(1,025)	614
Minority interest in profits (losses)	(81)	(256)	(223)	(285)	(845)	(252)	(301)	(388)	(250)	(1,191)
Net income (loss)	(2,547)	(1,558)	(1,136)	(6,943)	(12,184)	(3,487)	9,490	(4,042)	(2,825)	(864)
Net earnings (loss) per share	\$(0.13)	\$(0.08)	\$(0.06)	\$(0.35)	\$(0.63)	\$(0.18)	\$0.48	\$(0.21)	\$(0.14)	\$(0.04)
Weighted shares outstanding, diluted	19,261	19,449	19,542	19,570	19,456	19,571	19,677	19,625	19,600	19,618

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## ANALYST

Debra Fiakas, CFA is a seasoned, credentialed investment professional with a diversified and successful track record as a research analyst and as an investment banker. Her decade-plus career includes solid experience in all aspects of the equity capital markets with particular emphasis on emerging growth companies operating in the technology sectors. Ms. Fiakas is also the principal member of Crystal Equity Research, LLC.

## ANALYST CERTIFICATION

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## RATING SYSTEM

Buy	Price appreciation expected 10% or more over a 12-month period.
Hold	Price appreciation/depreciation expected between 10% and -10% over 12 months.
Sell	Price depreciation expected 10% or more over a 12-month period.

## CRYSTAL RESEARCH UNIVERSE

Buys	80%
Holds	5%
Sells	15%
Total	100%

## HISTORICAL RECOMMENDATIONS AND TARGET PRICE: XELB: Nasdaq

<u>Report</u>	<u>Date</u>	<u>Price</u>	<u>Rating</u>	<u>Target Price</u>
Initial	7/27/2022	\$1.10	Speculative Buy	\$4.80
Update	8/24/2022	\$1.14	Speculative Buy	\$4.80
Update	11/28/22	\$0.84	Speculative Buy	\$4.80



**DISCLOSURES**

<u>Name</u>	<u>Symbol: Exchange</u>	<u>Disclosures</u>
Xcel Brand, Inc.	XELB: Nasdaq	D

**Disclosure Key**

- A A member or employee of Crystal Equity Research, LLC serves on the board of directors of the company.
- B A controlling member of Crystal Equity Research, LLC has a beneficial interest in the common stock of the company.
- C A person or persons preparing this report or an immediate family member of the preparer has a beneficial interest in the common stock of the company.
- D Crystal Equity Research, LLC received compensation for research coverage from the company or one of its agents. The fees are paid in advance in cash.
- E The company has a convertible issue outstanding.
- F The securities covered in this report can be optioned.
- G The securities covered in this report can be margined.

**ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST**

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