

XELB / Nasdaq

**SPECULATIVE
BUY**

\$5.15

Target

CAPITALIZATION

Shares Outstanding (4/14/23)	19.62 M
Recent Price (4/24/22)	\$0.57

Market Capitalization	\$11.18 M
+ Debt	-0- M
- Cash	4.61 M
Enterprise Value	\$ 6.57 M

Book Value	\$70.14 M
Working Capital	\$ 7.46 M
Dividend	Nil

Balance sheet figures as of 12/31/22

MARKET DATA

Bid-Ask Spread, % Price	0.3%
52 Week High/Low	\$1.99 - \$0.56

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

Average Daily Volume	8 K
Short Interest, % of Float	0.7%
Beta	na

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

	FY21	FY22
Sales	\$37.93 M	\$25.78 M
(L)EBITDA	(4.35)	(15.28)
(L)EPS	(\$0.63)	(\$0.20)

Source: Company Reports

HIGHLIGHTS

- **New Operating Model.** Xcel Brands announces 'license plus' operating structure to build sales, eliminate inventory risk and reduce operating costs by as much as \$10 million per year. Some cost savings are expected as early as second quarter 2023.
- **Year-end 2023 Financial Results.** Xcel reported a net loss of \$4.02 million or \$0.20 per share on \$17.8 million in total licensing and product sales in the year 2022. Operations used \$14.18 million in cash resources.
- **Cash Kitty.** The Company held \$4.61 million in cash on its balance sheet at the end of 2022, providing the resources to make important strategic moves. Xcel remains debt-free.
- **Clear Path to Profitability.** With the change in operating structure, our revised earnings model suggests profitability could begin in the fourth quarter 2023. Sales and earnings should both ramp in 2024.
- **Valuation and Outlook.** An updated valuation exercise leads to a \$5.15 value and our new price target. We reiterate our Speculative Buy recommendation for XCEL.

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INDUSTRY: Consumer Cyclical, Apparel

XELB: NASDAQ

RECENT DEVELOPMENTS

Recently Xcel Brands management delivered welcome news to shareholders of plans to adjust the Company's operating structure to a 'license plus' business model. The Company began in early April to reduce staff focused on the production supply chain and expanded a license partnership for manufacture of branded apparel. As much as \$10 million in annual operating cost savings are expected as a result of the shift in structure as the Company leaves production and materials sourcing to larger partners with the scale to handle sourcing and supply challenges. By focusing on its own strengths in social commerce, shopping entertainment with livestreaming and communications with consumers, we expect the Company to experience faster growth at the top line as well as operating efficiencies. Indeed, management has guided for profitability beginning in the fourth quarter 2023.

RECOMMENDATION

We are more enthusiastic than ever about Xcel Brands. In our view, the move to streamline the business model is an astute move following monetization of the Company's success with its *Isaac Mizrahi* brand in May 2022. The earlier strategic change made it possible to deleverage Xcel's balance sheet and eliminate interest burden while retaining an equity interest in a strong apparel brand. The more recent decision to focus on core strengths in marketing and promotion offers great promise for generating sales growth and profits. Additionally, the move eliminates inventory risk.

With the adjustment in business model, we discarded our precedent transactions method to value XCEL and adopted comparable multiples method using ninety apparel companies. As expected, our valuation exercise resulted in higher intrinsic and future values.

Accordingly, we have adjusted our target price to \$5.15 per share. Our rating remains Speculative Buy as we acknowledge there is much to be proven by the Company as it carries out strategic plans. We expect brand announcement and earnings reports over the next few quarters to help boost confidence among shareholders and investors.

VALUATION		OPERATING PROJECTIONS				
Price/Sales	0.47 X	US\$	<u>2021A</u>	<u>2022A</u>	<u>2023E</u>	<u>2024E</u>
Price/Cash Flow	neg	Sales	\$37.93 M	\$25.78 M	\$ 17.65 M	\$ 25.00 M
Price/EPS	neg	Operating (Loss)	(12.56)	(22.54)*	(8.86)	3.25
Price/Book Value	0.17 X	CFO (U)	(6.56)	(14.18)	(3.63)	6.33 M
		EPS (LPS)	(\$0.63)	(\$0.20)	(\$0.39)	\$0.29
Consensus EPS 2023	na	<i>Dollars in millions except per share earnings</i>				
Forward PE	na	<i>*Excludes gain on sales of Isaac Mizrahi brand and income effects of other equity interests</i>				

Per share figures estimated 4/24/23

Company Reports and Crystal Equity Research Estimates

RESTRUCTURE FOR COST SAVINGS, SALES GROWTH

Last week in conjunction with release of fourth quarter and year-end 2022 financial results, Xcel Brands announced a significant restructure of its business model. Management is calling it “licensing plus” to emphasize the Company will be deploying more than simple license of brand names in the hope licensees are successful with consumers. Xcel Brands will continue to partner with strong apparel industry players, participating in joint ventures, engaging world-class designers, and deploying the Company’s unique video streaming and live television programming to reach consumers.

Management estimates the Company can save as much as \$10 million in annual operating costs by eliminating its wholesale product sales. The Company began reducing staffing and supply chain infrastructure in early April 2023. The savings will apparently ramp through the balance of the year, reaching the full savings level in the year 2024.

While adjustments to staffing have been rather low key, the Company has recently announced a string of new relationships to execute on its restructuring plans. We believe these types of relationship will be typical of Xcel’s ‘license plus’ strategy.

- Launch of *C. Wonder by Christian Siriano* on Home Shopping Network (HSN), featuring ready-to-wear styles exclusive for HSN.
- Strategic partnership between Xcel’s Longaberger and Charles & Colvard, Ltd., an expert in lab grown diamonds, for sales of Charles & Colvard Moissanite gems on the Longaberger website.
- New licensing agreement with national jewelry retailer and broadcast network Jewelry Television (JTV) for *Judith Ripka* fine jewelry. The license takes the place of a similar agreement with QVC, which is exiting the jewelry category.
- Expansion of relationship with One Jeanswear Group (OJG) with strategic license for the design and production of apparel products under Xcel’s *C. Wonder by Christian Siriano* brand.

The Company also revealed plans for its Longaberger asset. Apparently, all options are on the table from additional licenses, a strategic partnership, or possible sale of the Longaberger interest. Xcel Brands currently owns 50% interest in Longaberger Licensing, LLC, a joint venture with Hilco Global.

The restructuring plan comes along as the global apparel industry is forecast to post an estimated 7.0% growth in 2023. Indeed, fashion industry trends suggest the consumer is not held back by the economic adversity that has been grabbing headlines. For example, the consumer is investing in formal wear and not just daily necessities. The implications of a consumer prepared to invest in clothing for fun is perhaps most important in the U.S., which earned the largest apparel revenue in the world in 2022 at \$312 billion.

FOURTH QUARTER AND YEAR END FINANCIAL REPORT

Full Year 2022. Xcel Brands reported \$25.78 million in total sales in year 2022, of which licensing relationships contributed \$14.74 million and product sales another \$11.04 million. Gross profit margin on product sales was 27.7% during the full year compared to 33.6% in the full year 2021. In the third quarter ending September 2022, the Company had appeared to have cracked the nut on profitability in product sales, reaching a high of 37.3% gross profit margin on the segment. However, in the final three months of the year, even as sales, climbed higher costs took gross profits on product sales down to 13.9%.

Operating expenses for the full year 2022, held steady at \$40.35 million compared to \$39.82 million in the previous year. Higher SG&A spending and an uptick in depreciation and amortization expense largely contributed to the increase. Excluding asset impairment charges in both years operating expenses totaled \$40.07 in the recent year compared to \$38.45 million in the full year 2021.

Fourth Quarter. The Company's year-end report implies \$1.44 million in license fees and \$2.63 million in product sales in the fourth quarter ending December 2022. As noted above gross profits on product sales decline even as total revenue in the segment scaled higher.

As expected, license fees declined following the sale of 70% interest in the *Isaac Mizrahi* brand at the end of May 2022. The Company formed a joint venture in which its 30% interest in the brand is reported as an unconsolidated affiliate in other income. For its share the Company reported a net loss of \$1.2 million of which we estimate \$925,000 was attributable to the fourth quarter.

Operating expenses climbed sequentially to a total of \$10.18 million in the fourth quarter. As noted above SG&A spending was a greater burden in the quarter.

Balance Sheet. Xcel Brands held \$4.61 million in cash in the bank and no debt on its balance sheet at the end of December 2022. After selling a majority interest in the *Isaac Mizrahi* brand for \$43.39 million in cash, the Company paid off \$29.0 million in long-term debt. An additional \$14.18 million in cash was used to support operations during the year. We also note the Company invested \$600,000 in the *Isaac Mizrahi* joint venture and purchased \$265,000 in equipment for its operations.

In our view, monetization of the Company's success with the Mizrahi brand was strategically sound, enabling investment in new brands and more effective business models. Product manufacturing for wholesale and retail sales has become largely unmanageable for smaller-scale operations since the COVID-19 pandemic roiled world supply chains. By partnering for production and other elements of the apparel supply chain, Xcel Brands can concentrate on their strengths in social commerce using livestreaming, influencer relationships and e-commerce platforms.

ADJUSTED EARNINGS MODEL

Our earnings model has been updated to reflect financial results for the fourth quarter ending December 2022. We have also made adjustments to our assumptions for the current year based on management's commentary on plans for shift to a 'license plus' business model.

- Increased license fees from HSN following the exclusive launch of *C. Wonder by Christian Siriano* beginning in April 2023. We expect the first noticeable license fee increases in the second quarter ending June 2023, as the acclaimed designer has begun appearing on livestream programs.
- Increased license fees from *Judith Ripka* brand jewelry from national jewelry retailer and broadcast network Jewelry Television (JTV) beginning in June 2023. Commencement of livestream programming beginning in August 2023, should help drive *Judith Ripka* branded sales.
- Operating cost savings beginning in April 2023 and ramping through 2023, to eventually reach at least \$10 million annually beginning in 2024. The cost savings is expected to accrue from reduction in staffing and elimination of supply chain costs.
- Elimination of inventory burden by the beginning of 2024. This is being facilitated expansion of a manufacturing license with One Jeanswear Group (OJG), an expert in product development, fabric selection and materials sourcing. OJG will continue manufacturing Xcel's apparel brand *LOGO* by Lori Goldstein and play the same part for Xcel's *C. Wonder by Christian Siriano*.
- Reduction in days sales outstanding to 30 days based on a licensing business model.

The combination of these various changes is expected to become evident by the third quarter ending September 2023. In the meantime, first quarter ending March 2023, will likely be similar in revenue and costs to the fourth quarter ending December 2022. Our model reflects the June 2023 quarter as a transition period, wherein not all of the anticipated cost savings have yet been accomplished. Based on management's guidance the June quarter is expected to reflect noticeably higher sales and lower costs. Indeed, the fourth quarter 2022, is expected by management to be profitable. We note that our model reflects profitability by the fourth quarter 2022, in terms of cash earnings as calculated by 'earnings before depreciation and amortization' or EBITDA.

We believe Excel brands can return to its previous revenue level reached last year in 2022. The *C. Wonder* brand should be contributing meaningfully to the house and *Judith Ripka* jewelry sales should also enjoy a renaissance with new exposure at JTV. However, with the change in business structure we expect Company to realize significantly higher profits all around. Our model reflects profits of \$5.8 million before taxes in 2024 and \$8.25 million in 2025, when we believe the change in business structure should be fully represented.

The March quarter financial results will be released in the coming weeks, at which time we expect the Company to provide more details on how the restructuring effort is coming along. We will be looking particularly for an updated view on product sales and cost savings at the operating level. We expect to refine our earnings model at that time. In the meantime, even if still somewhat crude, our model demonstrates several key points: a shift to license fees as a primary revenue source, a reduction in operating expense and a clear path to profitability in the next twelve months.

A summary of our annual estimates is presented below in Table I and in Table II on page 8 we provide a quarterly breakdown for the current year 2023.

Table I: Summary Historical and Projected Sales and Earnings				
	2022 Actual	2023 Estimate	2024 Estimate	2025 Estimate
License fees	\$14.74 M	\$13.75 M	\$25.00 M	\$27.50 M
Product sales	<u>11.04</u>	<u>3.90</u>		
Total sales	25.78	17.65	25.00	\$ 27.50 M
Gross profit, total	17.80	13.45	25.00	27.50
Operating income (loss)	(2.30) M	(8.86) M	3.25 M	5.25 M
Earnings (loss) per share	(\$0.20)	(\$0.39)	\$0.29	\$0.41
Cash flow used by operations	(\$14.2) M	(\$ 32.3) M	(\$6.33) M	(\$6.33) M

Source: Company Reports and Crystal Equity Research Estimates

VALUATION

Previously, we had valued Xcel Brand shares using the precedent transaction method, in particular relying on the Company's own sales of majority interest in its *Isaac Misrahi* brand. However, with the shift in business model to largely a licensing situation, we are compelled to look to the larger group of publicly traded shares in the apparel industry.

A group of 90 apparel companies in the revenue range up to \$100 million, averages 0.8 times sales and 13.2 times earnings. From an enterprise standpoint the group averages of multiple of 9.5 times EBITDA or cash earnings. The multiples were derived in early 2023. In our view, the EV/EBITDA multiple is most appropriate given the fact that, unlike most of its peers, Xcel Brands has no debt. Applying the Enterprise Value to EBITDA comparable multiple to our estimated results for 2024, we reach a current market value of \$77.63 million for Xcel Brands or \$3.96 per share. Note that while we adjusted enterprise value by cash, no adjustment was needed for the Company debt-free balance sheet. Our calculations follow:

2024 estimates: $\$7.75\text{M} \times 9.5 = \$73.63 + \$4.0\text{M cash} = \$77.63 / 19.6\text{M shares} = \3.96

2025 estimates: $\$10.25\text{M} \times 9.5 = \$97.38 + \$4.0\text{M cash} = \$101.4 / 19.6\text{M shares} = \5.17

The exercise suggests that XCEL has an intrinsic value of \$3.96 based on 2024 figures. An appropriate future value in the next twelve to eight months of \$5.17, based on the valuation using 2025 figures. Accordingly, we adjusting our target price to \$5.15 per share, in concert with our favorable view of the Company's likely more profitable license operating structure.

VIEW AHEAD

Xcel shares currently trading at fractions of sales and book value. In our view, traders are applying to great a discount to the Company due to its continued losses. We believe that as the Company reports progress with its business model adjustments, the path to profits will become more evident. A revaluation is likely as the year 2023 unfolds. Events surrounding the Company's various brands will also provide an opportunity for Xcel management to discuss its new business relationships. *C. Wonder by Christian Siriano* at HSN, *Judith Ripka* and JVC and *Halston* in multiple venues are likely to trigger newsworthy developments over the next six months. Management is also keeping the Longaberger brand "on the front burner", promising another value triggering development in the next few months.

Table II: Historic and Projected Quarterly Sales and Earnings

Dollars in Thousands	2022				2022	2023				2023
	1Q	2Q	3Q	4Q	Year	1Q	2Q	3Q	4Q	Year
Net licensing revenue	5,961	5,175	2,166	1,435	14,737	1,500	3,000	4,250	5,000	13,750
Net product sales	2,786	3,292	2,335	2,631	11,044	2,600	1,300	-	-	3,900
Total revenue	8,747	8,467	4,501	4,066	25,781	8,747	8,467	4,250	5,000	17,650
Cost of product sales	1,680	2,570	1,465	2,265	7,980	2,050	2,150	-	-	4,200
Gross profit	7,067	5,897	3,036	1,801	17,801	7,067	5,897	4,250	5,000	13,450
Operating expenses:										
Salaries, benefits & taxes	4,853	5,236	3,301	3,412	16,802	3,075	2,365	1,998	2,250	9,688
Selling, general & administrative expenses	3,392	3,803	3,618	4,573	15,386	2,665	2,580	2,125	2,250	9,620
Depreciation and amortization	1,820	1,812	1,815	1,816	7,263	750	750	750	750	3,000
Other operating expenses	32	485	-	103	620	-	-	-	-	-
Asset impairment charges	-	-	-	274	274	-	-	-	-	-
Total operating expenses	10,097	6,293	8,734	10,178	40,345	6,490	5,695	4,873	5,250	22,308
Operating income (loss)	(3,030)	(1,445)	(5,698)	(8,377)	(22,544)	(4,440)	(3,545)	(623)	(250)	(8,858)
Other income (expense)										
Equity in earnings of unconsolidated affiliates	-	-	(277)	(925)	(1,202)	(500)	-	250	350	100
Interest expense	(708)	(479)	-	(16)	(1,203)	-	-	-	-	-
Loss on extinguishment of debt	-	(2,324)	-	-	(2,324)	-	-	-	-	-
Other, net	(1)	20,609	6	(28)	20,586	-	-	-	-	-
Total other income (expense)	(709)	17,806	(271)	(69)	16,757	(500)	-	250	350	100
Income (loss) before income taxes	(3,739)	6,265	(5,969)	(8,315)	(16,135)	(4,940)	(3,545)	(373)	100	(8,758)
Provision for income taxes (benefit from)	-	3,178	(1,539)	(2,070)	(431)	-	-	-	-	-
Minority interest in profits (losses)	(252)	(301)	(388)	(397)	(1,338)	(250)	(250)	(250)	(250)	(1,000)
Net income (loss)	(3,487)	9,490	(4,042)	(5,979)	(4,018)	(4,690)	(3,295)	(123)	350	(7,758)
Net earnings (loss) per share	\$(0.18)	\$0.48	\$(0.21)	\$(0.30)	\$(0.20)	\$(0.24)	\$(0.17)	\$(0.01)	\$0.02	\$(0.39)
Weighted shares outstanding, diluted	19,571	19,677	19,625	19,625	19,625	19,750	19,750	19,750	19,750	19,750

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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.

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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	75%
Holds	10%
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
Update	4/25/23	\$0.57	Speculative Buy	\$5.15

DISCLOSURES

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

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- 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.

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