

XELB / Nasdaq

**SPECULATIVE  
BUY**

**\$5.15**

Target

**CAPITALIZATION**

Shares Outstanding (5/15/23) 19.68 M

Recent Price (5/22/23) \$0.85

Market Capitalization \$16.73 M

+ Debt -0- M

- Cash 1.61 M

Enterprise Value \$15.12 M

Book Value \$64.26 M

Working Capital \$ 3.74 M

Dividend Nil

Balance sheet figures as of 3/31/23

**MARKET DATA**

Bid-Ask Spread, % Price 11.4%

52 Week High/Low \$1.99 - \$0.51

Shares Outstanding 19.68 M

Inside Ownership 56%

Institutional Ownership 20%

Estimated Flotation 8.66 M

Average Daily Volume 17 K

Short Interest, % of Float 0.1%

Beta 1.40

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**

- **Master License.** A new master licensee has been signed with an industry-leading wholesaler for the iconic *Halston* brand. Xcel management expects significantly higher sales beginning with the Spring 2024 season.
- **Upfront Payment.** The master licensee gave Xcel Brands and upfront payment and has guaranteed minimum royalty payments. Although undisclosed, we estimate the upfront cash payment could be in excess of \$5.0 million.
- **Incremental Cost Savings.** The master license agreement is making it possible to realize additional cost savings as part of the Company's shift to a license-plus' business model. Management now estimates \$13 million in annual operating cost savings.
- **Estimates and Valuation Upside.** Increased future sales of *Halston* branded apparel and additional operating cost-savings afford upside to our current earnings model. We are foregoing a model revision until results for the June 2023 quarter provide greater clarity on magnitude and timing of both incremental sales and savings.
- **Price Catalyst.** Disclosure of the identity of the new master licensee for the *Halston* brand should boost shareholder confidence and provide justification for building new long-positions in XCEL shares.

**Debra Fiakas, CFA**  
Security Analyst  
212-400-7519  
dfiakas@crystalequityresearch.com

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INDUSTRY: Consumer Cyclical, Apparel

XELB: NASDAQ

## RECENT DEVELOPMENTS

Xcel Brands delivered encouraging strategic news with the announcement of a new master license agreement for its *Halston* brand. A major apparel wholesaler has given Xcel Brands an upfront cash payment for the deal and committed to minimum guaranteed royalties over a 25-year license period. The wholesaler's expansive distribution channels with department stores, e-commerce and other retailers are expected to significantly increase sales of *Halston* branded apparel beginning with the Spring 2024 season. The identity of the wholesaler will be disclosed in the coming weeks.

The master license agreement is the latest development in Xcel's effort to shift to a 'license-plus' business model, eliminating the Company's wholesale activities. It is also a victory for Xcel's strategy of acquiring and rejuvenating distressed and languishing luxury brands, then realizing strong returns on invested capital as the brands regain marketability.

The *Halston* development is also contributing to incremental operating cost savings that are expected through elimination of additional personnel and overhead costs. Management is now estimating \$13.0 million in annual operating cost savings, 30% greater than the previous estimate of \$10 million in cost savings. Reduced operating costs are expected to begin in the current quarter ending June 2023, and build throughout the balance of the year.

## RECOMMENDATION

We continue to rate XELB at Speculative Buy and reiterate our \$5.15 price target over the next twelve months.

In our view, the stock is exceptionally undervalued. Indeed, the *Halston* license agreement implies higher future revenue streams and reduced operating costs than are currently reflected in our earnings estimates. We expect to make additional changes to our earnings model based on financial results from the June 2023 quarter, increasing sales beginning in 2024 and reducing operating costs beginning yet in 2023. This upside potential in our estimates implies a commensurate increase in valuation and our target price.

We look to the Company's quarter reports and disclosure of its new master license partner for its *Halston* brand to trigger new investor interest. The identity of the master licensee should be particularly inspiring given Xcel management's characterization of the wholesaler as an industry leader.

## VALUATION

Price/Sales	0.71 X
Price/Cash Flow	neg
Price/EPS	neg
Price/Book Value	0.25 X
Consensus EPS 2023	na
Forward PE	na

## OPERATING PROJECTIONS

US\$	2021A	2022A	2023E	2024E
Sales	\$37.93 M	\$25.78 M	\$ 19.60 M	\$ 25.00 M
Operating (Loss)*	(16.14)	(5.79)	(10.23)	4.75
CFO (U)	( 6.56)	(14.18)	(2.07)	5.10 M
EPS (LPS)	(\$0.63)	(\$0.20)	(\$0.47)	\$0.29

*Dollars in millions except per share earnings*

*\*Operating income before taxes*

*Per share figures estimated 5/22/23*

*Company Reports and Crystal Equity Research Estimates*

## NEW MASTER LICENSE – realizing returns from Halston investment

Along with the financial report for first quarter 2023, Xcel Brands announced the formation just three days earlier of a master license for its *Halston* apparel brand. The 25-year license agreement gives the licensee the right to use the *Halston* name for women's, men's and children's apparel, fashion accessories and related products in exchange for an upfront cash payment and royalties. Characterized as a well-recognized wholesaler with a commanding market share built on retail, department store and e-commerce channels, the licensee has agreed to guaranteed royalties based on minimum annual sales levels.

The *Halston* announcement was short on specifics. Nonetheless, Xcel management promised to disclose the identity of the licensee in the coming weeks. The licensee has apparently taken a particular interest in the *Halston* brand, taking an option to purchase the brand name for \$5.0 million at the end of the 25-year license period. The Company also issued the licensee a ten-year warrant for one million shares of Xcel Brands at an exercise price of \$1.50.

The *Halston* brand has a storied history, originated in the 1960s by its namesake, Roy Halston Frowick. Although a troubled personal life left Frowick behind by the mid-1980s, the glamorous and sophisticated lines he brought to the runways has remained with the luxury brand. The halter dress and plunging front and back neckline are widely recognized as Halston-inspired. Changing control several times, the *H Halston* trademarks were acquired by Xcel Brands in 2014, and the *Halston* and *Halston Heritage* trademarks in 2019.

While the amounts of the trademark purchases were not disclosed, management has indicated the Company has since invested significantly to revitalize the *Halston* brand. Most recently, Xcel Brands recruited Ken Downing as the creative director for the brand. Downing was previously the fashion director for Neiman Marcus and has held creative roles at several other high-profile projects.

The effort has apparently paid off as the Company had been inking new licenses for the updated *Halston* style in the U.S. and the UK. Now the master licensee will take over existing relationships and open its own market channels for the brand. Xcel management expects a significant increase in sales volume when the new licensee begins selling the Spring 2024 season.

The *Halston* license relationship is part of Xcel's plan to shift its operating structure to a 'license-plus' business model, in which the Company engages capable licensees for its brand portfolio and facilitates market penetration with its unique social commerce capabilities. Xcel has built considerable knowhow in televised and video shopping and is building a network of influencers using social platforms. The Company's wholesale channel is winding down, reducing working capital requirements and eliminating inventory risks.



## HIGHLIGHTS FROM FIRST QUARTER 2023 FINANCIAL RESULTS

Annual Cost Savings. During the customary conference call with analysts and shareholders that followed the first quarter announcement, discussion of financial performance was overshadowed by management's update on changes to its operating structure. The annual cost savings that is expected to ensue from the restructuring is now estimated at \$13 million annually, a 30% increase in savings from the previously announced figure of \$10 million. The additional savings is due in part to the master license agreement for *Halston*, which allows the Company to conserve even more on personnel costs and overhead. The Company's personnel count is expected to decline by as much as 60%, shrinking to approximately 40 individuals by end of 2023.

Cash Resources. We also took note of management's comments on the Company's current cash and working capital balance near and estimated \$10 million. Given net working capital of \$3.7 million at the end of March 2023, the higher current total working capital figure suggests the Company may have received as much as \$5.0 million as the upfront cash payment from the new *Halston* master licensee.

Whatever figure the Company eventually discloses as the upfront payment, we believe Xcel Brands is in a materially better financial position to execute on its strategic plans subsequent to the close of the recently reported quarter. The Company used \$2.9 million in cash resources to support operations in the first quarter, leaving \$1.6 million in total cash on the balance sheet at the end of March 2023. With significant cost and expense reductions already underway, we expect positive operating cash generation to begin by at least the September 2023 quarter.

Balance Sheet De-risking. Product sales totaled \$3.8 million in the quarter, significantly higher than the same quarter in the previous year. The increase was largely due to the sale of all *C Wonder* inventory to the Home Shopping Network, a move which is part of the Company's restructuring effort. Total inventory at the end of March 2023 was \$3.1 million, slightly higher than three months earlier. Nonetheless, during the earnings conference call management indicated that inventory will be largely liquidated by the end of the June 2023, as the Company moves away from the role of wholesaler. The move reduces the risk of returns and holding unmarketable inventory should economic fortunes turn adverse for the consumer, a circumstance which has been observed in as recently as the last two years.

## EARNINGS MODEL UPDATE

Our model has been updated to reflect the financial performance in the first quarter ending March 2023. In addition to higher-than-expected product sales, net licensing revenue was greater than we had reflected in our model. While tempting, we are not increasing our license fee or product sales estimate for the second quarter ending June 2023. The June quarter will be impacted by sales of the Company's current inventory to its new partners and the upfront payment related to the *Halston* master license could be reflected in license revenue. Importantly, these one-time transactions will be incremental to our topline estimates.

Operating Cost Savings. Management now anticipates an incremental \$3.0 million in cost savings related to its shift to a licensing operating structure and the elimination of wholesale activity. However, we have not adjusted our operating expense estimates to reflect \$13 million in annual costs savings, leaving our model reflecting the \$10 million in annual cost savings previously guided by management. We expect the June 2023 quarter to provide insight into the pace of cost savings as well as incremental costs related to the 'plus' element in the Company's new 'licensing-plus' model. We believe it is preferable to wait for the second quarter report to adjust our model with greater confidence.

While Xcel Brands is reducing personnel and is moving away from managing a supply chain, the Company will continue to cultivate an important social commercial platform with livestreaming as a core component. Indeed, as an example of the Company's effort to bring entertainment to the shopping experience, the celebrated model and fashion icon, Christie Brinkley, will be appearing on HSN on the Company's behalf in the coming months. Management is also building out what they call a 'many-to-many' sales model that capitalizes on short-form video content. We expect the June quarter report to provide greater clarity on the costs of social commerce strategy under the developing license-plus business model.

2024 Estimates Upside. We also expect to make additional adjustments to our estimates at the end of the June 2024 quarter to better reflect the recent new license agreements. At present we have not included in the year 2024, the incremental sales of the *Halston* branded apparel and accessories that management anticipates from its new master licensee beginning with the Spring 2024 season. We expect the anticipated disclosure of the master licensee to be helpful in determining a more reliable estimate of *Halston*-related future sales. We also expect to be in a better position at that time to estimate the timing and magnitude of minimum guaranteed royalties from the master licensee.

Our updated estimates are shown in an annual basis in Table I below and in more detail in Table II on page 7. The model reflects the trajectory of the changes underway in the Company's business model with a cessation of product sales and the addition of licenses for Xcel Brands portfolio of apparel brands.

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

	2022 Actual	2023 Estimate	2024 Estimate	2025 Estimate
License fees	\$14.74 M	\$14.47 M	\$25.00 M	\$27.50 M
Product sales	11.04	5.13		
Total sales	25.78	19.60	25.00	\$ 27.50 M
Gross profit, total	17.80	14.76	25.00	27.50
Operating income (loss) before taxes	(5.79) M	(10.23) M	4.75 M	7.25 M
Earnings (loss) per share	(\$0.20)	(\$0.47)	\$0.29	\$0.41
Cash flow used by operations	(\$14.18) M	(\$ 2.07) M	\$5.10 M	\$10.66 M

Source: Company Reports and Crystal Equity Research Estimates

## VALUATION

Our valuation of XELB was recently shifted to the comparable method using a group of 90 apparel companies with publicly traded shares. We applied an Enterprise Value to EBITDA multiple to our estimated results for 2024, to reach a current market value of \$77.63 million and 2025 estimated results for a target market value of \$5.17 per share. The future value informed our target price of \$5.15 per share in the next year.

A review of current stock prices for the 90 apparel companies suggests that sentiment in the apparel industry remains unchanged despite continued worries about inflation and geopolitical disruptions in Europe. Accordingly, we are standing by our valuation and retaining our price target of \$5.15.

A review of price multiples for XELB on a trailing basis, suggests the stock is severely undervalued. At the current price level, the stock is trading at 0.71 times sales in the trailing twelve months ending March 2023. From an asset standpoint, the stock is trading at 0.25 times the Company's book value, which is composed primarily of the Xcel's brand portfolio. The master license agreement for *Halston* suggests the Company has developed a solid formula for acquiring and rebuilding careworn brands. Accordingly, Xcel's brand portfolio could be worth more than is reflected in book value.

## OUTLOOK

Given the upside we anticipate for our sales and earnings estimates, we believe our valuation exercise is quite conservative. Unfortunately, given the current share price well below \$1.00, it may take one or two quarter reports from the Company for our view to seem credible. Thus, the Company's quarter reports could serve as important catalysts for the stock price. More importantly, we expect additional disclosures related to the new master licensee for the *Halston* brand to earn win favorable attention for the stock.

Importantly, as the second calendar quarter unfolds, volatility in the broader U.S. equity market presents an unfavorable backdrop for achieving fair valuation for micro- and small-cap companies. Evidence that inflation has been tamed and stabilization of interest-rates in the U.S. should be helpful in firming up sentiment toward equity. With an estimated beta near 1.40 for XELB, the vagaries of the broader U.S. equity market should not be overlooked as a strong influence on the stock price.



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	2,222	3,000	4,250	5,000	14,472
Net product sales	2,786	3,292	2,335	2,631	11,044	3,828	1,300	-	-	5,128
Total revenue	8,747	8,467	4,501	4,066	25,781	6,050	4,300	4,250	5,000	19,600
Cost of product sales	1,680	2,570	1,465	2,265	7,980	2,693	2,150	-	-	4,843
Gross profit	7,067	5,897	3,036	1,801	17,801	3,357	2,150	4,250	5,000	14,757
Operating expenses:										
Salaries, benefits & taxes	4,853	5,236	3,301	3,412	16,802	3,465	2,365	1,998	2,250	10,078
Selling, general & administrative expenses	3,392	3,803	3,618	4,573	15,386	3,492	2,580	2,125	2,250	10,448
Depreciation and amortization	1,820	1,812	1,815	1,816	7,263	1,797	1,000	1,000	1,000	4,797
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	8,755	5,945	5,123	5,500	25,323
Operating income (loss)	(3,030)	(1,445)	(5,698)	(8,377)	(22,544)	(5,398)	(3,795)	(873)	(500)	(10,566)
Other income (expense)										
Equity in earnings of unconsolidated affiliates	-	-	(277)	(925)	(1,202)	(515)	250	250	350	335
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	(25)	-	-	-	-
Total other income (expense)	(709)	17,806	(271)	(69)	16,757	(540)	250	250	350	335
Income (loss) before income taxes	(3,739)	6,265	(5,969)	(8,315)	(16,135)	(5,938)	(3,545)	(623)	(150)	(10,231)
Provision for income taxes (benefit from)	-	3,178	(1,539)	(2,070)	(431)	-	-	-	-	-
Minority interest in profits (losses)	(252)	(301)	(388)	(397)	(1,338)	(295)	(250)	(250)	(250)	(1,045)
Net income (loss)	(3,487)	9,490	(4,042)	(5,979)	(4,018)	(5,643)	(3,295)	(373)	100	(9,186)
Net earnings (loss) per share	\$(0.18)	\$0.48	\$(0.21)	\$(0.30)	\$(0.20)	\$(0.29)	\$(0.17)	\$(0.02)	\$0.01	\$(0.47)
Weighted shares outstanding, diluted	19,571	19,677	19,625	19,625	19,625	19,633	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.

## 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	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
Update	5/23/23	\$0.85	Speculative Buy	\$5.15



**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.
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