

XELB / Nasdaq

**SPECULATIVE
BUY**

\$6.00 (from \$5.15)

Target

CAPITALIZATION

Shares Outstanding (8/09/23)	19.71 M
Recent Price (8/14/22)	\$1.92

Market Capitalization	\$37.84 M
+ Debt	-0- M
- Cash	3.51 M
Enterprise Value	\$34.33 M

Book Value	\$60.62 M
Working Capital	\$ 4.74 M
Dividend	Nil

Balance sheet figures as of 6/30/23

MARKET DATA

Bid-Ask Spread, % Price	1.0%
52 Week High/Low	\$2.10 - \$0.51

Shares Outstanding	19.71 M
Inside Ownership	56%
Institutional Ownership	21%
Estimated Flotation	8.69 M

Average Daily Volume	217 K
Short Interest, % of Float	1.16%
Beta	1.65

Source: Bloomberg LP

INVESTMENT RETURNS

	XELB	Sector
Return on Equity	neg	33.94%
Return on Assets	neg	12.53%
Return on Capital	neg	17.70%

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

- **Quarter Financial Report.** Xcel Brands delivers better-than-expected revenue of \$6.9 million in second quarter ending June 2023, as the Company effectively executes on a restructuring strategy.
- **Reduced Operating Expense.** The Company also continued delivery on an estimated \$13 million in annual operating cost savings as part of its restructuring plan. Operating expenses were trimmed in the second quarter to \$5.2 million from \$9.5 million a year ago.
- **Balance Sheet Strength.** Cash resources totaled \$3.51 million at the end of June 2023, as the Company received license payments in the quarter. The Company's no-debt capitalization is unchanged.
- **Resilient Valuation.** Xcel Brands' pivot to a license-plus media business model positions the Company among peers earning better than sector average valuation multiples. We estimate intrinsic value is now \$4.96 per share, well above the current share price.
- **New Target Price.** Our target price is revised upward to \$6.00 for the next twelve to eighteen months based in part on the successful shift in the Company's business model to one with lower operating risk.

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INDUSTRY: Consumer Cyclical, Apparel

XELB: NASDAQ

RECENT DEVELOPMENTS

Xcel Brands delivered higher revenue than we had expected in the second quarter ending June 2023, as product sales were boosted by sales of inventory to the new licensee of the *Judith Ripka* fine jewelry brand. The topline was just the first of several details in the Company's quarter report that reflected the impact of a restructuring plan initiated earlier in the year. Xcel is making a rapid pivot to what management calls its 'license plus' business model that relies on strong license partners who take on inventory risk while Xcel contributes its considerable expertise in streaming media and social commerce to support its brand portfolio. The inventory sale left the company with \$798,000 in total inventory, which is expected to further decline in coming quarters as the Company shifts working capital needs to its partners.

Previously, management had estimated potential reduction of annual operating costs by as much as \$13 million. The quarter report confirms the team is delivering on the promised savings as cash operating expenses in the June 2023 quarter were \$5.2 million. This compares to \$9.5 million in the same quarter of the previous year and \$7.0 million in the first quarter 2023.

The Company has nearly completed its shift to a brand license strategy, with strong names such as WHP Group, G-III Apparel Group and One Jeanswear among its licensing partners. Management apparently is still working on the best arrangement for its *Longaberger* home goods brand. Also in the works is a new digital 'marketplace' that will serve as a compensation platform for individuals following and promoting the Company's brands. Management has guided for significant savings in advertising costs with implementation of the marketplace, which enables a shift away from digital advertising platforms toward more effective social commerce.

RECOMMENDATION

We reiterate our Speculative Buy rating of XCEL with an elevated price target of \$6.00 in the next twelve to eighteen months. The increase in our price objective follows an updated valuation exercise that reflects adjusted estimates for the years 2024 and 2025, as well as shifts in comparable valuation metrics in the apparel sector. Our valuation exercise is presented on pages 6 and 7 of this report.

The stock has moved higher in recent weeks, in large part due to bullish commentary from the Company's newest brand licensees. Xcel's partners for its iconic *Isaac Mizrahi* and *Halston* brands have already begun strategies to grow and build distribution of apparel and other consumer products bearing these well-known names. Supportive commentary and information from the license partners.

VALUATION

Price/Sales	1.74 X
Price/Cash Flow	neg
Price/EPS	neg
Price/Book Value	0.62 X
Consensus EPS 2023	na
Forward PE	na

OPERATING PROJECTIONS

US\$	2021A	2022A	2023E	2024E
Sales	\$37.93 M	\$25.78 M	\$ 22.08 M	\$ 25.00 M
Operating (Loss)	(12.56)	(22.54)*	(12.74)	1.50
CFO (U)	(6.56)	(14.18)	(1.39)	4.52
EPS (LPS)	(\$0.63)	(\$0.20)	(\$0.60)	\$0.09

Dollars in millions except per share earnings

Per share figures estimated 8/14/23

Company Reports and Crystal Equity Research Estimates

QUARTER REPORT HIGHLIGHTS

Xcel Brands delivered better than expected performance in the quarter ended June 2023, even as management pushed forward with strategies to address changing apparel industry economics. The Company reported \$6.8 million in total revenue from a mix of license fees and product sales.

- License fees totaled \$2.4 million in the quarter, well below the same period a year-ago. The decline was expected since the Company sold a 70% interest in the *Isaac Mizrahi* brand to a joint venture with WHP Global, two which certain license arrangements were transferred.
- Sales of apparel and other products totaled \$4.4 million in the quarter, boosted in part by the sale of inventory to a new licensee of the Company's *Judith Ripka* jewelry brand. Gross profit on product sales was \$553,000 or 12.7% of product sales. This compares to gross profit margin of 21.9% in the same quarter in the previous year. The dip in profitability was largely due to favorable pricing of inventory transferred to the licensee of the *Judith Ripka* brand, Jewelry Television.

Operating expenses in the quarter were also impacted by management's efforts to restructure the Company's operations. In announcing a move to a license model for its apparel and accessories brands, management promised as much as \$13 million in annual savings in operating expenses. Delivery of a portion of those savings was in evidence in the quarter as total operating expenses declined to \$5.2 million in the quarter ending June 2023, compared to \$9.5 million in the same period a year ago. Salaries, benefits and other costs were \$2.2 million following a reduction in staff that began in February 2023. This compares to employee expenses of \$5.2 million in the year ago period. Selling, general and administrative (SG&A) expenses were also trimmed to \$2.9 million in the June 2023 quarter from \$4.3 million in the same quarter a year ago.

Depreciation and amortization expense totaled \$1.8 million in the quarter, commensurate with the year-ago period. Shareholders might expect amortization expense to decline given that trademarks and other intangible assets have been reduced \$44.6 million from \$96.8 million in March 2022, the last reported quarter before the sale of a majority interest in the *Isaac Mizrahi* brand. However, Company must still report its share of amortization of intangible assets created under the purchase accounting method used following the sale of the Mizrahi brand to a joint venture with WHP Global.

Strong Balance Sheet and Positive Cash Flow

We estimate Xcel Brand generated \$1.5 million in cash resources from operations in the quarter ending June 2023. After dipping into the bank account to support operations throughout the year 2022 and early 2023, the Company benefitted in the June 2023 quarter from an upfront cash payment from a new licensee totaling an estimated \$5.0 million. The payment has been recorded as a new deferred revenue liability and will be recognized over the next few periods as the new license relationship unfolds.

The Company held \$3.5 million in cash resources at the end of June 2023.












RESTRUCTURE PROGRESS

Management's efforts to remake Xcel Brands' operating structure were in evidence throughout the Company's June quarter report. The Company aspires to be positioned as licensor of premium brands for apparel, footwear and other consumer products. License arrangements have been made for nearly all brands in the Company's portfolio, with additional planning and negotiations still underway for the Longaberger brand for household goods.

Without the need for production arrangements or inventory investments, the Company has eliminated risks of wage and materials costs increases as well as obsolete inventory. At the end of June 2023, inventory had been reduced to \$798,000, compared to \$2.8 million at the end of December 2022.

Unlike most other licensors, Xcel Brands retains considerable day-to-day attention in its brands. The Company will continue to apply its extensive expertise in social commerce and the use of live streaming for commerce. During the earnings conference call management teased analysts and shareholders with promises of a surprise celebrity appearance to kick off sales of *Judith Ripka* fine jewelry on the Jewelry Television platform in October 2023. Previously, the Company disclosed arrangements with a well-known female model for appearances beginning in the Fall 2023. Notably, management has sought revenue or profit-sharing agreements with celebrities, which should help align mutual interests as well as the Company's cash flow.

BRAND PORTFOLIO - LICENSE MODEL

	<i>BRAND</i>		<i>LICENSE PARTNER</i>
	Isaac Mizrahi	IP Topco, LLC, joint venture with WHP Global	
	Halston	G-III Apparel Group, LLC	
	Judith Ripka	America's Collectibles Network as Jewelry Television or JTV	
	C. Wonder	One Jeanswear Group	
	Lori Goldstein	One Jeanswear Group	
	Longaberger	Longaberger Licensing LLC joint venture with Hilco Baskets, LLC	na

Sources: Brand and company websites

Marketplace for Social Commerce

The restructuring effort is accompanied by enhancement of the Company's social commerce capacity. Xcel Brands apparently has under development a new platform to better manage the economics of social commerce participants. During the second quarter earnings conference call, management indicated its 'marketplace' platform is nearing completion, providing a few details on implementation through both desktop application and mobile app. Management touts its platform as a major step forward in 'democratizing the market' by enabling payments to the everyday shopper as a consumer influencer. Management expects implementation of the platform to enable a shift in advertising spend from online ad servers to individuals, creating a net savings in total advertising and marketing costs.

UPDATED EARNINGS MODEL

Our model has been updated to reflect financial performance reported in the second quarter ending June 2023. The addition of better-than-expected revenue streams in the quarter brings our sales estimate for 2023 to \$22.08 million from \$17.65 million. We have elected to leave unchanged our estimate of revenue from license fees in the third and final quarters of 2023. Product sales are still expected to end at the end with the June quarter, although we acknowledge there could be nominal revenue from this source yet in the second half of 2023, given that the Company still had \$798,000 in inventory on its balance sheet at the end of June 2023.

Our topline estimate is more aggressive than the figure provided by management of \$19.0 million in total revenue for the year 2023. We expect sales activity to pick up dramatically in the third quarter with new marketing efforts for the *Judith Ripka* and *C. Wonder* brands. Anecdotally, Christian Siriano, as the new designer for *C. Wonder*, has been well received in live stream programming for the brand. *Judith Ripka* should benefit from celebrity endorsement in fall 2023. It follows that both brands could contribute amply to license fees in the second half of the year.

Notably, we have left unchanged our estimates of operating expenses in the second half of 2023. During the earnings conference call management indicated additional savings are expected in the second half of 2023. Indeed, our operating expense estimates reflect additional savings, but not as deep as suggested by management.

We are unwavering in our estimate that license fees could grow in 2024, by more than 10% year-over-year. This view is built on recent bullish comments made by leadership at one of Xcel Brand's newest licensees, G-III Apparel Group, suggesting the addition of the *Halston* brand to the G-III portfolio is capable of replacing Calvin Klein or Tommy Hilfer brands should either license deal not be renewed at expiration in 2025 or 2027, respectively. With \$3.1 billion in annual sales, G-III has a significant international footprint that would take the *Halston* brand to consumers well beyond the brand's historic European market. Additionally, G-III apparently has plans to invest in new design talent to take the *Halston* style into footwear and jewelry.

Accordingly, we have left unchanged our estimate of \$24.0 million in total sales in the year 2024. Indeed, our topline objective could be conservative as G-III relaunches the *Halston* brand in Spring 2024. We have made some adjustments to cost and expense assumptions, that together take operating income to \$1.5 million in 2024. Cash flow from operations is now estimated at \$4.52 million. Our scenario for 2024, is somewhat more conservative than management's guidance for an operating expense run rate near \$4.0 million per quarter or \$16.0 million per year.

Table I: Summary Historical and Projected Sales and Earnings

	2022 Actual	2023 Estimate	2024 Estimate	2025 Estimate
License fees	\$14.74 M	\$13.90 M	\$25.00 M	\$27.50 M
Product sales	<u>11.04</u>	<u>8.18</u>		
Total sales	25.78	22.08	25.00	\$ 27.50 M
Gross profit, total	17.80	15.59	25.00	27.50
Operating income (loss)	(2.30) M	(12.74) M	1.50 M	4.25 M
EBITDA (LBITDA)	4.01 M	(5.66) M	7.50 M	9.25 M
Earnings (loss) per share	(\$0.20)	(\$0.60)	\$0.09	\$0.23
Cash flow used by operations	(\$14.2) M	(\$ 1.39) M	\$4.52 M	\$9.66 M

Source: Company Reports and Crystal Equity Research Estimates

VALUATION REVISITED

In our view, Xcel Brands' balance sheet is as important as its projected sales performance. With no debt on its balance sheet and inventory risk nearly eliminated, the balance sheet is in excellent condition. With breakeven profits near at hand, the Company has a solid footing to debut its new 'marketplace', completing its restructuring effort for a license-plus business model. Cash resources can be used for implementation of the Company brand acquisition strategy.

Returning to our recent enterprise valuation exercise using comparable multiples of EBITDA (earnings before interest, taxes, depreciation and amortization), we find that over the last few months our selected group of apparel companies has shown considerable resilience in maintaining value. Our collection of selected apparel sector participants has been winnowed down to 40 (from 90) in favor of companies with license portfolios and greater strength in digital commerce. The enterprise value of the refined group is trading at a multiple of 12.60 times EBITDA, well above the 9.75 multiple prevailing in the first few months of 2023.

Applying the updated multiple to our revised EBITDA estimates for Xcel Brands in 2024 and 2025, we reach an intrinsic value of \$4.95 and a future value of \$6.06. Our math follows below:

2024 revised estimates:

$$\$7.50\text{M} \times 12.50 = \$93.75 + \$4.0\text{M cash} = \$97.75 / 19.75\text{M shares} = \$4.95$$

2025 estimates:

$$\$9.25\text{M} \times 12.50 = \$97.38 + \$4.0\text{M cash} = \$101.4 / 19.75\text{M shares} = \$6.06$$

Accordingly, we are adjusting our target price to \$6.00 per share in the next twelve to eighteen months. In our view, Xcel Brands has earned the higher valuation by pivoting to a lower risk business model with nominal working capital requirements. Conservative business practices are likely to return the Company to profitability in the next year and with excess cash resources Xcel Brands is able to move opportunistically in its market to acquire additional brands.

As a check on our enterprise valuation, we turned to other comparable market multiples. We have unfortunately observed a recent contraction in valuation metrics for the apparel industry. For example, price to sales ratio for the broader industry has declined from 1.04 at the end of the March 2023 quarter to 0.66 in the last month. Likewise, price to book value is now near 4.14 compared to 7.18 three months ago. Nonetheless, applying even these muted trailing multiples to our estimates for 2024, implies a significantly higher target price of \$6.93. (\$25.0M total sales x 0.66 / 19.71 sh = \$0.83 and \$62.0M book value x 4.14 / 19.71 sh = \$13.02; average of \$6.93).

Our collection of selected apparel sector participants is valued slightly higher at the topline than the broader industry group with a price to sales ratio of 0.81. However, our smaller group has a similar price to book value multiple of 4.42. The same math exercise leads to a target price of \$7.47. (\$25.0M total sales x 0.81 / 19.75 sh = \$1.03 and \$62.0M book value x 4.42 / 19.75 sh = \$13.90; average of \$7.47).

OUTLOOK

XELB moved higher in the last two months, partially closing the gap between current and fair value. While we have adjusted our price target upward to \$6.00 per share, we note there is line of volume-related price resistance at the \$2.50 price level. We also note the stock has a 5-year high price near \$4.25. This means reaching our price target, means clearing a near-by hurdle and then driving upward to unprecedented values. We expect each quarter report to provide news of fundamental accomplishments with the Company's new operating model in terms of cost savings and branded growth.

One of the most important drivers for the stock price could be continued on-schedule execution on the Company's strategic shift to a 'licensing-plus' business model. Each quarter financial report over the next year should serve as a strong catalyst for the share price. We also expect Xcel's high-profile licensees to stand as credible references for future revenue.

Dollars in Thousands	2022				2022 Year	2023				2023 Year	2024 Year
	1Q	2Q	3Q	4Q		1Q	2Q	3Q	4Q		
Net licensing revenue	5,961	5,175	2,166	1,435	14,737	2,222	2,428	4,250	5,000	13,900	25,000
Net product sales	2,786	3,292	2,335	2,631	11,044	3,828	4,353	-	-	8,181	-
Total revenue	8,747	8,467	4,501	4,066	25,781	6,050	6,781	4,250	5,000	22,081	25,000
Cost of product sales	1,680	2,570	1,465	2,265	7,980	2,693	3,800	-	-	6,493	-
Operating expenses:											
Salaries, benefits & taxes	4,853	5,236	3,301	3,412	16,802	3,465	2,241	1,998	2,000	9,704	8,750
Selling, general & administrative expenses	3,392	3,803	3,618	4,573	15,386	3,493	2,943	2,125	2,250	10,811	9,500
Other operating expenses	32	485	-	103	620	-	-	-	-	-	-
Asset impairment charges	-	-	-	274	274	-	-	-	-	-	-
Total operating expenses	8,277	9,524	6,919	8,362	33,082	6,958	5,184	4,123	4,250	20,515	18,250
Other income (expense)											
Depreciation and amortization	(1,820)	(1,812)	(1,815)	(1,816)	(7,263)	(1,797)	(1,786)	(1,750)	(1,750)	(7,083)	(6,000)
Equity in unconsolidated affiliates	-	-	(277)	(925)	(1,202)	(515)	(515)	(250)	(250)	(1,530)	750
Gain on sale of assets	-	20,608	-	(22)	20,586	-	351	-	-	351	-
Loss on lease liability	-	-	-	-	-	-	445	-	-	445	-
Total other income (expense)	(1,820)	18,796	(2,092)	(2,763)	12,121	(2,312)	(1,505)	(2,000)	(2,000)	(7,817)	(5,250)
Operating income (loss)	(3,030)	15,169	(5,975)	(9,324)	(3,160)	(5,913)	(3,708)	(1,873)	(1,250)	(12,744)	1,500
Finance charges											
Interest expense	(708)	(479)	-	(16)	(1,203)	-	-	-	-	-	-
Loss on extinguishment of debt	-	(2,324)	-	-	(2,324)	-	-	-	-	-	-
Gain on reduction of contingent obligation	-	-	-	900	900	-	-	-	-	-	-
Other, net	(1)	1	6	(6)	-	(25)	-	-	-	(25)	-
Total other income (expense)	(709)	(2,802)	6	878	(2,627)	(25)	7	-	-	(18)	-
Income (loss) before income taxes	(3,739)	12,367	(5,969)	(8,446)	(5,787)	(5,938)	(3,701)	(1,873)	(1,250)	(12,762)	1,500
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)	(233)	(250)	(250)	(1,028)	(250)
Net income (loss)	(3,487)	9,490	(4,042)	(5,979)	(4,018)	(5,643)	(3,468)	(1,623)	(1,000)	(11,734)	1,750
Net EPS (loss)	\$ (0.18)	\$ 0.48	\$ (0.21)	\$ (0.30)	\$ (0.20)	\$ (0.29)	\$ (0.18)	\$ (0.08)	\$ (0.05)	\$ (0.60)	\$ 0.09
Weighted shares outstanding, diluted	19,571	19,677	19,625	19,625	19,625	19,633	19,736	19,750	19,750	19,717	20,000

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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	70%
Holds	15%
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	4/25/2023	\$0.57	Speculative Buy	\$5.15
Update	5/23/2023	\$0.85	Speculative Buy	\$5.15
Update	8/23/2023	\$1.90	Speculative Buy	\$6.00

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.
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