

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___ to ___

Commission File Number: 001-37527

XCEL BRANDS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

76-0307819

(I.R.S. Employer Identification No.)

1333 Broadway, 10th Floor, New York, NY 10018

(Address of Principal Executive Offices)

(347) 727-2474

(Issuer's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 4, 2016, there were 18,680,560 shares of common stock, \$.001 par value per share, of the issuer outstanding.

XCEL BRANDS, INC.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Xcel Brands, Inc. and Subsidiaries
Unaudited Condensed Consolidated Balance Sheets
(in thousands, except share and per share data)

	<u>September 30, 2016</u>	<u>December 31, 2015</u>
	(Unaudited)	(Note 1)
Assets		
Current Assets:		
Cash and cash equivalents	\$ 15,158	\$ 16,860
Accounts receivable, net	8,804	7,594
Prepaid expenses and other current assets	455	655
Total current assets	<u>24,417</u>	<u>25,109</u>
Property and equipment, net	2,456	871
Trademarks and other intangibles, net	111,502	112,323
Goodwill	12,371	12,371
Restricted cash	1,509	1,109
Other assets	282	343
Total non-current assets	<u>128,120</u>	<u>127,017</u>
Total Assets	<u>\$ 152,537</u>	<u>\$ 152,126</u>
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable, accrued expenses and other current liabilities	\$ 4,678	\$ 3,372
Deferred revenue	12	597
Current portion of long-term debt	5,302	8,918
Current portion of long-term debt, contingent obligations	-	250
Total current liabilities	<u>9,992</u>	<u>13,137</u>
Long-Term Liabilities:		
Long-term debt, less current portion	31,094	31,860
Deferred tax liabilities, net	6,746	6,749
Other long-term liabilities	2,074	297
Total long-term liabilities	<u>39,914</u>	<u>38,906</u>
Total Liabilities	<u>49,906</u>	<u>52,043</u>
Commitments and Contingencies		
Stockholders' Equity:		
Preferred stock, \$.001 par value, 1,000,000 shares authorized, none issued and outstanding	-	-
Common stock, \$.001 par value, 35,000,000 shares authorized at September 30, 2016 and December 31, 2015, and 18,680,560 and 18,434,634 issued and outstanding at September 30, 2016 and December 31, 2015, respectively	19	18
Paid-in capital	96,563	93,999
Retained earnings	6,049	6,066
Total Stockholders' Equity	<u>102,631</u>	<u>100,083</u>
Total Liabilities and Stockholders' Equity	<u>\$ 152,537</u>	<u>\$ 152,126</u>

See Notes to Unaudited Condensed Consolidated Financial Statements.

Xcel Brands, Inc. and Subsidiaries
Unaudited Condensed Consolidated Statements of Operations
(in thousands, except share and per share data)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues				
Net licensing revenue	\$ 8,311	\$ 7,289	\$ 25,748	\$ 20,082
Net e-commerce sales	20	47	91	166
Total revenues	<u>8,331</u>	<u>7,336</u>	<u>25,839</u>	<u>20,248</u>
Cost of goods sold	41	51	147	131
Gross profit	<u>8,290</u>	<u>7,285</u>	<u>25,692</u>	<u>20,117</u>
Operating expenses				
Salaries, benefits and employment taxes	4,054	3,463	12,481	9,639
Other design and marketing costs	779	669	2,439	1,761
Other selling, general and administrative expenses	1,145	961	4,439	2,482
Stock-based compensation	1,089	1,292	3,754	3,413
Depreciation and amortization	387	373	1,172	953
Total operating expenses	<u>7,454</u>	<u>6,758</u>	<u>24,285</u>	<u>18,248</u>
Other expenses (income)				
Gain on reduction of contingent obligation	-	-	-	(3,000)
Loss on extinguishment of debt	-	-	-	1,371
Total other income, net	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,629)</u>
Operating income	<u>836</u>	<u>527</u>	<u>1,407</u>	<u>3,498</u>
Interest and finance expense				
Interest expense - term debt	340	304	1,003	925
Other interest and finance charges	122	128	424	451
Total interest and finance expense	<u>462</u>	<u>432</u>	<u>1,427</u>	<u>1,376</u>
Income (loss) from continuing operations before income taxes	374	95	(20)	2,122
Income tax provision (benefit)	<u>256</u>	<u>51</u>	<u>(3)</u>	<u>35</u>
Income (loss) from continuing operations	118	44	(17)	2,087
Loss from discontinued operations, net	<u>-</u>	<u>(14)</u>	<u>-</u>	<u>(281)</u>
Net income (loss)	<u>\$ 118</u>	<u>\$ 30</u>	<u>\$ (17)</u>	<u>\$ 1,806</u>
Basic and diluted net income (loss) per share:				
Continuing operations	\$ 0.01	\$ 0.00	\$ (0.00)	\$ 0.14
Discontinued operations, net	-	(0.00)	-	(0.02)
Net income (loss)	<u>\$ 0.01</u>	<u>\$ 0.00</u>	<u>\$ (0.00)</u>	<u>\$ 0.12</u>
Diluted net income (loss) per share:				
Continuing operations	\$ 0.01	\$ 0.00	\$ (0.00)	\$ 0.13
Discontinued operations, net	-	(0.00)	-	(0.02)
Net income (loss)	<u>\$ 0.01</u>	<u>\$ 0.00</u>	<u>\$ (0.00)</u>	<u>\$ 0.11</u>
Basic weighted average common shares outstanding	<u>18,692,775</u>	<u>17,187,272</u>	<u>18,608,034</u>	<u>15,380,609</u>
Diluted weighted average common shares outstanding	<u>19,068,011</u>	<u>18,278,182</u>	<u>18,608,034</u>	<u>16,471,519</u>

See Notes to Unaudited Condensed Consolidated Financial Statements.

Xcel Brands, Inc. and Subsidiaries
Unaudited Condensed Consolidated Statements of Cash Flows
(in thousands)

**For the Nine Months Ended
September 30,**
2016 **2015**

Cash flows from operating activities

Net (loss) income	\$	(17)	\$	1,806
Adjustments to reconcile net (loss) income to net cash provided by operating activities:				
Loss from discontinued operations, net		-		281
Depreciation and amortization expense		1,172		953
Amortization of deferred finance costs		140		116
Stock-based compensation		3,754		3,413
Recovery of allowance for doubtful accounts		-		(21)
Amortization of note discount		236		333
Deferred income tax benefit		(3)		(5)
Tax benefit from vested stock grants and exercised options		-		(83)
Non-cash property exit charge		648		-
Gain on reduction of contingent obligation		-		(3,000)
Loss on extinguishment of debt		-		1,371
Changes in operating assets and liabilities:				
Accounts receivable		(1,210)		(3,829)
Prepaid expenses and other assets		199		(141)
Accounts payable, accrued expenses and other current liabilities		1,306		(1,040)
Deferred revenue		(585)		415
Other liabilities		1,129		718
Net cash provided by operating activities from continuing operations		6,769		1,287

Net cash provided by operating activities from discontinued operations, net		-		104
Net cash provided by operating activities		6,769		1,391

Cash flows from investing activities

Cash consideration for asset acquisition of the H Halston Brand		-		(14)
Cash consideration for asset acquisition of the C Wonder Brand		-		(3,586)
Cost to acquire additional intangible assets		(26)		-
Purchase of property and equipment		(1,911)		(94)
Restricted cash for security deposits		(400)		(1,112)
Net cash used in investing activities		(2,337)		(4,806)

Cash flows from financing activities

Proceeds from issuance of common stock, net of direct costs		-		16,107
Proceeds from exercise of stock options and warrants		20		65
Tax benefit from vested stock grants and exercised options		-		83
Shares repurchased including vested restricted stock in exchange for withholding taxes		(1,210)		(711)
Payment of deferred finance costs		(69)		(10)
Payment of long-term debt		(4,625)		(2,256)
Payment of QVC Earn-Out obligation		(250)		-
Payment of installment obligations related to the acquisition of the Ripka Brand		-		(2,190)
Net cash (used in) provided by financing activities		(6,134)		11,088

Net (decrease) increase in cash and cash equivalents		(1,702)		7,673
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Cash and cash equivalents, beginning of period		16,860		8,531
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Cash and cash equivalents, end of period	\$	15,158	\$	16,204
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Supplemental disclosure of non-cash activities:

Issuance of common stock in connection with C Wonder Brand acquisition	\$	-	\$	9,000
Contingent obligation related to acquisition of the C Wonder Brand	\$	-	\$	2,850
Issuance of common stock as payment for a portion of the Ripka Seller Notes	\$	-	\$	5,400
Issuance of common stock as payment for a portion of the QVC Earn-Out	\$	-	\$	2,515

Supplemental disclosure of cash flow information:

Cash paid during the period for income taxes	\$	168	\$	447
Cash paid during the period for interest	\$	909	\$	855

XCEL BRANDS, INC. AND SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2016
(Unaudited)

1. Nature of Operations, Background, and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and pursuant to the instructions to Form 10-Q and Rule 10-01 of Regulation S-X promulgated by the United States Securities and Exchange Commission (“SEC”). Certain information or footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted, pursuant to the rules and regulations of the SEC for interim financial reporting. Accordingly, they do not include all the information and footnotes necessary for a comprehensive presentation of financial position, results of operations, or cash flows.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements were prepared following the same policies and procedures used in the preparation of the audited consolidated financial statements and reflect all adjustments (consisting of normal recurring adjustments) necessary to present fairly the results of operations, financial position, and cash flows of Xcel Brands, Inc. and its subsidiaries (the “Company”). The results of operations for the interim periods presented herein are not necessarily indicative of the results for the entire fiscal year or for any future interim periods. These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the SEC on March 17, 2016.

The Company is a brand management and media company engaged in the design, production, licensing, marketing, and direct to consumer sales of branded apparel, footwear, accessories, jewelry, home goods, and other consumer products, and the acquisition of dynamic consumer lifestyle brands. Currently, the Company’s brand portfolio consists of the Isaac Mizrahi brand (the “Isaac Mizrahi Brand”), the Judith Ripka brand (the “Ripka Brand”), the H by Halston and H Halston brands (collectively, the “H Halston Brands”), the C Wonder brand (the “C Wonder Brand”), and the Highline Collective brand. The Company also managed and designed the Liz Claiborne New York brand (“LCNY Brand”) through July 31, 2016.

The Company licenses its brands to third parties, provides certain design, production, and marketing services, and generates royalty design and service fee revenues through licensing and other agreements with manufacturers and retailers. These activities include licensing its own brands for promotion and distribution through a ubiquitous-channel retail sales strategy, which encompasses distribution through interactive television, the internet, and traditional brick-and-mortar retail channels.

In December 2014, the Company decided to close its retail stores. Accordingly, the Company’s retail operations are treated and presented as discontinued operations (see Note 8).

Certain reclassifications have been made to the prior period condensed consolidated financial statements to conform to the current period presentation.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2016-09, “Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). ASU 2016-09 requires that all excess tax benefits and tax deficiencies be recognized in the income statement as discrete tax items in the interim period in which they occur, clarifies that employee taxes paid when an employer withholds shares for tax purposes should be presented on the statement of cash flows as a financing activity, and changes the presentation of excess tax benefits on the statement of cash flows from a financing activity to an operating activity. ASU 2016-09 also provides for a policy election to either estimate the number of awards expected to vest (as per current GAAP) or account for forfeitures when they occur. This new accounting guidance is effective for public companies for fiscal years beginning after December 15, 2016 (i.e., calendar years beginning on January 1, 2017), including interim periods within those fiscal years. Early adoption is permitted in any interim or annual period. The Company is currently evaluating the impact that the adoption of ASU 2016-09 will have on the Company’s consolidated financial statements.

XCEL BRANDS, INC. AND SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2016
(Unaudited)

In April 2016, the FASB issued Accounting Standards Update No. 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing" ("ASU 2016-10"), and in May 2016, the FASB issued Accounting Standards Update No. 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" ("ASU 2016-12"). These Accounting Standards Updates contain amendments that provide additional guidance, clarification, and practical expedients related to ASU No. 2014-09 "Revenue from Contracts with Customers" ("ASU 2014-09"), which was issued by the FASB in May 2014. ASU 2016-10 amends certain aspects of the guidance in ASU 2014-09 related to identifying performance obligations and applying the new revenue guidance to licensing transactions. ASU 2016-12 addresses topics of collectability, presentation of sales tax collected from customers, non-cash consideration, contract modifications and completed contracts at transition, and transition disclosures. The Company will incorporate the guidance contained in ASU 2016-10 and ASU 2016-12 into its overall evaluation and adoption of ASU 2014-09, which collectively will be effective for fiscal years beginning after December 15, 2017 and interim periods therein. The Company is currently evaluating the impact that the adoption of these ASUs will have on the Company's consolidated financial statements.

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, "Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). ASU 2016-15 provides guidance and clarification regarding the presentation and classification on the Statement of Cash Flows for eight specific cash flow issues, including:

- debt prepayment and extinguishment costs,
- settlement of zero-coupon (or insignificant coupon interest rate) debt instruments,
- contingent consideration payments made after a business combination,
- proceeds from settlement of insurance claims,
- proceeds from settlement of corporate-owned life insurance policies,
- distributions received from equity method investees,
- beneficial interests in securitization transactions, and
- separately identifiable cash flows / application of predominance principle.

This new accounting guidance is effective for public companies for fiscal years beginning after December 15, 2017 (i.e., calendar years beginning on January 1, 2018), including interim periods within those fiscal years. Entities must apply the guidance retrospectively to all periods presented but may apply it prospectively from the earliest date practicable if retrospective application would be impracticable. Early adoption is permitted, provided all amendments are adopted in the same period. The Company is currently evaluating the impact that the adoption of ASU 2016-15 will have on its consolidated financial statements.

2. Trademarks, Goodwill and Other Intangibles

Trademarks and other intangibles, net consist of the following:

	September 30, 2016			
(\$ in thousands)	Weighted-Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Trademarks (indefinite-lived)	n/a	\$ 96,676	\$ -	\$ 96,676
Trademarks (definite-lived)	15 years	15,463	1,201	14,262
Licensing agreements	4 years	2,000	2,000	-
Non-compete agreement	7 years	562	140	422
Copyrights and other intellectual property	10 years	190	48	142
Total		\$ 114,891	\$ 3,389	\$ 111,502

	December 31, 2015			
(\$ in thousands)	Weighted-Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Trademarks (indefinite-lived)	n/a	\$ 96,676	\$ -	\$ 96,676
Trademarks (definite-lived)	15 years	15,437	429	15,008
Licensing agreements	4 years	2,000	2,000	-
Non-compete agreement	7 years	562	80	482
Copyrights and other intellectual property	10 years	190	33	157
Total		\$ 114,865	\$ 2,542	\$ 112,323

Amortization expense for intangible assets for the quarter ended September 30, 2016 (the "Current Quarter") and the quarter ended September 30, 2015 (the "Prior Year Quarter") was \$282,000 and \$211,000, respectively. Amortization expense for intangible assets for the nine months ended September 30, 2016 ("Current Nine Months") and the nine months ended September 30, 2015 (the "Prior Year Nine Months") was \$847,000 and \$525,000, respectively.

The trademarks related to the Isaac Mizrahi Brand, the Ripka Brand, and the H Halston Brands have been determined to have indefinite useful lives, and accordingly no amortization has been recorded for these assets.

XCEL BRANDS, INC. AND SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2016
(Unaudited)

The Company has \$12.371 million of goodwill related to the 2011 acquisition of the Isaac Mizrahi business. There was no change in goodwill during the Current Nine Months.

3. Significant Contracts

QVC Agreements

Under the Company's agreements with QVC, QVC is required to pay the Company fees based primarily on a percentage of its net sales of Isaac Mizrahi, Ripka, H Halston, and C Wonder branded merchandise. QVC royalty revenue represents a significant portion of the Company's total revenues. Revenues from QVC totaled \$7.00 million and \$6.30 million for the Current Quarter and Prior Year Quarter, respectively, representing approximately 84% and 86% of the Company's total revenues, respectively. Revenues from QVC totaled \$22.14 million and \$17.78 million for the Current Nine Months and the Prior Year Nine Months, respectively, representing approximately 86% and 88% of the Company's total revenues, respectively. As of September 30, 2016 and December 31, 2015, the Company had receivables from QVC of \$7.27 million and \$6.40 million, respectively, representing approximately 83% and 84% of the Company's total receivables, respectively. Total receivables include \$0.29 million and \$1.18 million of earned revenue that had been accrued but not billed as of September 30, 2016 and December 31, 2015, respectively.

4. Debt

The Company's net carrying amount of debt is comprised of the following:

(\$ in thousands)	September 30, 2016	December 31, 2015
Xcel Term Loan	\$ 26,125	\$ -
IM Term Loan	-	11,375
JR Term Loan	-	7,875
H Term Loan	-	10,000
Unamortized deferred finance costs related to term loans	(485)	(493)
IM Seller Note	3,627	4,918
Ripka Seller Notes	495	469
Contingent obligation - IM Seller	-	250
Contingent obligation - JR Seller	3,784	3,784
Contingent obligation - CW Seller	2,850	2,850
Total	36,396	41,028
Current portion (i)	5,302	9,168
Long-term debt	\$ 31,094	\$ 31,860

(i) The current portion of long-term debt as of September 30, 2016 consists of (a) \$3.875 million related to the Xcel Term Loan and (b) \$1.427 million related to the IM Seller Note.

Xcel Term Loan

On February 26, 2016, Xcel and its wholly owned subsidiaries, IM Brands, LLC, JR Licensing, LLC, H Licensing, LLC, C Wonder Licensing, LLC, Xcel Design Group, LLC, IMNY Retail Management, LLC, and IMNY E-Store, USA, LLC (each a "Guarantor" and collectively, the "Guarantors"), as Guarantors, entered into an Amended and Restated Loan and Security Agreement (the "Loan Agreement") with Bank Hapoalim B.M. ("BHI"), as agent (the "Agent"), and the financial institutions party thereto as lenders (the "Lenders"). The Loan Agreement amended and restated the IM Term Loan, the JR Term Loan, and the H Term Loan. Pursuant to the Loan Agreement, Xcel assumed the obligations of each of IM Brands, LLC, JR Licensing, LLC, and H Licensing, LLC under the respective term loans with BHI in the aggregate principal amount of \$27,875,000 (the loan under the Loan Agreement is referred to as the "Xcel Term Loan").

XCEL BRANDS, INC. AND SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2016
(Unaudited)

The Xcel Term Loan matures on January 1, 2021. Principal on the Xcel Term Loan is payable in quarterly installments on each of January 1, April 1, July 1 and October 1. The aggregate remaining annual principal payments are as follows:

(\$ in thousands)	Amount of Principal Payment
Year Ending December 31,	
2016 (October 1 through December 31)	\$ 875
2017	4,000
2018	4,000
2019	4,000
2020	4,000
2021	9,250
Total	\$ 26,125

Under the Loan Agreement, the Company has the right to prepay the Xcel Term Loan, provided that any prepayment of less than all of the outstanding balance shall be applied to the remaining amounts due in inverse order of maturity. If the Xcel Term Loan is prepaid on or prior to the third anniversary of the closing date (including as a result of an event of default), the Company shall pay an early termination fee as follows: an amount equal to the principal amount outstanding under the Term Loan on the date of prepayment, multiplied by: (i) two percent (2.00%) if the Xcel Term Loan is prepaid on or after the closing date and on or before the second anniversary of the closing date; and (ii) one percent (1.00%) if the Xcel Term Loan is prepaid after the second anniversary of the closing date and on or before the third anniversary of the closing date.

Commencing with the fiscal year ending December 31, 2017, the Company is required to repay a portion of the Xcel Term Loan in an amount equal to 10% of the excess cash flow for the fiscal year; provided that no early termination fee shall be payable with respect to any such payment. Excess cash flow means, for any period, cash flow from operations (before certain permitted distributions) less (i) capital expenditures not made through the incurrence of indebtedness, (ii) all cash interest and principal and taxes paid or payable during such period, and (iii) all dividends declared and paid during such period to equity holders of any credit party treated as a disregarded entity for tax purposes.

Xcel's obligations under the Loan Agreement are guaranteed by the Guarantors and secured by all of the assets of Xcel and the Guarantors (as well as any subsidiary formed or acquired that becomes a credit party to the Loan Agreement) and, subject to certain limitations contained in the Loan Agreement, equity interests of the Guarantors (as well as any subsidiary formed or acquired that becomes a credit party to the Loan Agreement).

The Loan Agreement contains customary covenants, including reporting requirements, trademark preservation, and the following financial covenants of the Company (on a consolidated basis with the Guarantors and any subsidiaries subsequently formed or acquired that become a credit party under the Loan Agreement):

- net worth (as defined in the Loan Agreement) of at least \$90,000,000 at the end of each fiscal quarter ending on June 30 and December 31 of each fiscal year;
- liquid assets of at least \$5,000,000, until such time as the ratio of indebtedness to EBITDA (as defined in the Loan Agreement) is less than 1.00 to 1.00 and, in which event, liquid assets must be at least \$3,000,000;
- a fixed charge ratio of at least 1.20 to 1.00 for each fiscal quarter ended June 30 and December 31 for the twelve fiscal month period ending on such date;
- capital expenditures shall not exceed (i) \$2,650,000 for the year ending December 31, 2016 and (ii) \$700,000 for any fiscal year thereafter; and
- EBITDA (as defined in the Loan Agreement) of \$9,500,000 for the fiscal year ending December 31, 2016; and \$9,000,000 for each fiscal year thereafter.

The Company was in compliance with all applicable covenants as of September 30, 2016.

XCEL BRANDS, INC. AND SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2016
(Unaudited)

In connection with the refinancing of its term loan debt, the Company paid \$116,000 of fees to or on behalf of BHI. These fees, along with \$466,000 of remaining unamortized deferred finance costs related to the previous term loan debt, have been deferred on the condensed consolidated balance sheet as a reduction to the carrying value of the Xcel Term Loan, and are being amortized to interest expense over the term of the Xcel Term Loan using the interest method.

Interest on the Xcel Term Loan accrues at a fixed rate of 5.1% per annum and is payable on each day on which the scheduled principal payments are required to be made. For the Current Quarter and Prior Year Quarter, the Company incurred interest expense of \$340,000 and \$304,000, respectively, related to the Xcel Term Loan. For the Current Nine Months and Prior Year Nine Months, the Company incurred interest expense of \$1,003,000 and \$918,000, respectively, related to the Xcel Term Loan.

IM Seller Note

On September 29, 2011, as part of the consideration for the purchase of the Isaac Mizrahi Business, the Company issued to IM Ready-Made, LLC (“IM Ready”) a promissory note in the principal amount of \$7,377,000 (as amended, the “IM Seller Note”). The stated interest rate of the IM Seller Note was 0.25% per annum. Management determined that this rate was below the Company’s expected borrowing rate, which was then estimated at 9.25% per annum. Therefore, the Company discounted the IM Seller Note by \$1,740,000 using a 9.0% imputed annual interest rate, resulting in an initial value of \$5,637,000. In addition, on September 29, 2011, the Company prepaid \$123,000 of interest on the IM Seller Note. The imputed interest amount was amortized over the term of the IM Seller Note and recorded as other interest and finance expense on the Company’s condensed consolidated statements of operations.

On December 24, 2013, the IM Seller Note was amended to (1) revise the maturity date to September 30, 2016, (2) revise the date to which the maturity date may be extended to September 30, 2018, (3) provide the Company with a prepayment right with its common stock, subject to remitting in cash certain required cash payments and a minimum common stock price of \$4.50 per share, and (4) require interim scheduled payments.

On September 19, 2016, the IM Seller Note was further amended and restated to (1) revise the maturity date to March 31, 2019, (2) require six semi-annual principal and interest installment payments of \$750,000, commencing on September 30, 2016 and ending on March 31, 2019, (3) revise the stated interest rate to 2.236% per annum, (4) allow for optional prepayments at any time at the Company’s discretion without premium or penalty, and (5) require that all payments of principal and interest be made in cash. Management assessed and determined that this amendment represented a debt modification and, accordingly, no gain or loss was recorded.

The Company paid the scheduled semi-annual installment payment of \$750,000 on September 30, 2016. The aggregate remaining annual principal payments under the IM Seller Note are as follows:

(\$ in thousands)	Amount of Principal Payment
Year Ending December 31,	
2016 (October 1 through December 31)	\$ -
2017	1,427
2018	1,459
2019	741
Total	<u>\$ 3,627</u>

For the Current Quarter and Prior Year Quarter, the Company incurred interest expense of \$70,000 and \$79,000, respectively, which includes amortization of the discount on the IM Seller Note of \$70,000 and \$74,000, respectively. For the Current Nine Months and the Prior Year Nine Months, the Company incurred interest expense of \$210,000 and \$237,000, respectively, which includes amortization of the discount on the IM Seller Note of \$210,000 and \$223,000, respectively.

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Ripka Seller Notes

On April 3, 2014, as part of the consideration for the purchase of the Ripka Brand, JR Licensing issued to Ripka promissory notes in the aggregate principal amount of \$6,000,000 (the "Ripka Seller Notes"). The Ripka Seller Notes have a term of five years from the date of issuance, are payable in cash or shares of the Company's common stock valued at the time of payment, at the Company's option, and with a floor price of \$7.00 per share if paid in stock, with Ripka having certain rights to extend the maturity of the Ripka Seller Notes in the event the Company's stock is trading at a price of less than \$7.00 per share. On February 20, 2015, a portion of the Ripka Seller Notes was amended and satisfied.

Management determined that the Company's expected borrowing rate was estimated to be 7.33% per annum and, therefore, discounted the Ripka Seller Notes by \$1,835,000 using a 7.33% imputed annual interest rate, resulting in an initial value of \$4,165,000. The imputed interest amount is being amortized over the term of the Ripka Seller Notes and recorded as other interest and finance expense on the Company's condensed consolidated statements of operations.

On February 20, 2015, the Company agreed to cancel Ripka Seller Notes in the principal amount of \$3.0 million and execute in its place: (i) a \$2.4 million principal amount promissory note issued in the name of Ripka (the "\$2,400,000 Seller Note") and (ii) a \$600,000 principal amount promissory note issued in the name of Ripka (the "\$600,000 Seller Note"), each with substantially the same terms as the Ripka Seller Notes; provided, however, that the Company and Ms. Ripka agreed that, upon Ripka's assignment of the \$600,000 Seller Note to a permitted assignee, the principal payments under the \$600,000 Seller Note shall accelerate to be payable in eight equal quarterly installments of \$75,000 with the first payment due on March 31, 2015 and with the final principal payment payable on December 31, 2016. As of the date of the filing of this Quarterly Report on Form 10-Q, the \$600,000 Seller Note has not been assigned. The \$2,400,000 Seller Note was assigned by Ripka to Judith Ripka Creations, Inc. and then assigned by Judith Ripka Creations, Inc. to Thai Jewelry Manufacturer Co. LTD. ("Thai Jewelry").

On February 20, 2015, the Company entered into a release letter (the "Release Letter") with Thai Jewelry, pursuant to which the Company agreed to issue to Thai Jewelry an aggregate of 266,667 shares of the Company's common stock in exchange for the cancellation of the \$2,400,000 Seller Note. On March 25, 2015, the Company issued the shares of common stock pursuant to the Release Letter. The carrying value, net of the discount at the time of the redemption of the \$2.4 million Ripka Seller Notes was \$1.79 million and, as a result, the Company recorded a loss on the early extinguishment of debt of \$0.61 million during the Prior Year Nine Months, which is included in the accompanying condensed consolidated statements of operations.

On April 21, 2015, the Company satisfied an additional \$3.00 million principal amount of the Ripka Seller Notes by issuing 333,334 shares of the Company's common stock. The carrying value, net of the discount at the time of the redemption of the \$3.00 million Ripka Seller Notes was \$2.24 million and, as a result, the Company recorded a loss on the early extinguishment of debt of \$0.76 million, and when combined with the loss recorded on February 20, 2015, totals a \$1.37 million loss on the early extinguishment of debt which is included in the accompanying Prior Year Nine Months condensed consolidated statements of operations.

For both the Current Quarter and Prior Year Quarter, the Company incurred interest expense of \$9,000 and \$8,000, respectively, which consists solely of amortization of the discount on the Ripka Seller Notes. For the Current Nine Months and the Prior Year Nine Months, the Company incurred interest expense of \$26,000 and \$96,000, respectively, which consists solely of amortization of the discount on the Ripka Seller Notes.

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Contingent Obligation – IM Seller (QVC Earn-Out)

The Company was obligated to pay IM Ready \$2.76 million, payable in cash or common stock, at the Company's option, contingent upon IM Brands receiving aggregate net royalty income of at least \$2.5 million from QVC in the twelve-month period ended September 30, 2015 with the number of shares of such stock based upon the greater of (x) \$4.50 per share, and (y) the average stock price for the last twenty business days prior to the time of such issuance. The \$2.5 million in net royalty income from QVC for the twelve-month period ended September 30, 2015 was met and, therefore, the Company issued IM Ready 290,473 shares of common stock, valued at \$2.51 million as of September 30, 2015 and made a \$0.25 million payment in cash in January 2016 to satisfy this obligation.

Contingent Obligation – JR Seller (Ripka Earn-Out)

In connection with the purchase of the Ripka Brand, the Company agreed to pay Ripka additional consideration of up to \$5 million in aggregate (the "Ripka Earn-Out"), payable in cash or shares of the Company's common stock based on the fair market value of the Company's common stock at the time of payment, and with a floor of \$7.00 per share, based on the Ripka Brand achieving in excess of \$1 million of net royalty income during each of the 12-month periods ending on October 1, 2016, 2017 and 2018, less the sum of all earn-out payments for any prior earn-out period. Net royalty income does not include any revenues generated by interactive television sales or any revenue accelerated as a result of termination of any license agreement. The Ripka Earn-Out of \$3.78 million is recorded in the accompanying condensed consolidated balance sheets based on the difference between the fair value of the acquired assets of the Ripka Brand at the acquisition date and the total consideration paid. In accordance with ASC Topic 480, the Ripka Earn-Out obligation is classified as a liability in the accompanying condensed consolidated balance sheets because of the variable number of shares payable under the agreement.

Contingent Obligations – CW Seller (C Wonder Earn-Out)

In connection with the purchase of the C Wonder Brand, the Company agreed to pay the seller additional consideration (the "C Wonder Earn-Out"), which would be payable, if at all, in cash or shares of common stock of the Company, at the Company's sole discretion, after June 30, 2019, with a value based on the royalties related directly to the assets the Company acquired pursuant to the purchase agreement. The value of the earn-out shall be calculated as the positive amount, if any, of (i) two times (A) the maximum net royalties as calculated for any single twelve month period commencing on July 1 and ending on June 30 between the closing date and June 30, 2019 (each, a "Royalty Target Year") less (B) \$4,000,000, plus (ii) two times the maximum royalty determined based on a percentage of retail and wholesale sales of C Wonder branded products by the Company as calculated for any single Royalty Target Year. The C Wonder Earn-Out of \$2.85 million is recorded in the accompanying condensed consolidated balance sheets based on the probability of the C Wonder Brand achieving certain net royalty income targets within the earn-out periods and then calculating the present value of the weighted average payment amount. In accordance with ASC Topic 480, the C Wonder Earn-Out obligation is classified as a liability in the accompanying condensed consolidated balance sheets because of the variable number of shares payable under the agreement.

As of September 30, 2016 and December 31, 2015, total contingent obligations were \$6.63 million and \$6.88 million, respectively.

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5. Stockholders' Equity

2011 Equity Incentive Plan

The Company's 2011 Equity Incentive Plan, as amended and restated (the "Plan"), is designed and utilized to enable the Company to provide its employees, officers, directors, consultants and others whose past, present and/or potential contributions to the Company have been, are or will be important to the success of the Company, an opportunity to acquire a proprietary interest in the Company. A total of 13,000,000 shares of common stock are eligible for issuance under the Plan. The Plan provides for the grant of any or all of the following types of awards: stock options, restricted stock, deferred stock, stock appreciation rights and other stock-based awards. The Plan is administered by the Company's Board of Directors, or, at the Board's discretion, a committee of the Board.

Effective September 13, 2016, the Plan was amended to (a) increase the number of shares of common stock reserved and available for distribution under the Plan from 8,000,000 to 13,000,000, and (b) increase the maximum number of shares of common stock with respect to which options or restricted stock may be granted to any participant from 5,000,000 to 10,000,000.

The fair value of options and warrants is estimated on the date of grant using the Black-Scholes option pricing model. The valuation determined by the Black-Scholes option pricing model is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. The risk-free rate is based on the U.S. Treasury rate for the expected life at the time of grant, volatility is based on the average long-term implied volatilities of peer companies, the expected life is based on the estimated average of the life of options and warrants using the simplified method, and forfeitures are estimated on the date of grant based on certain historical data. The Company utilizes the simplified method to determine the expected life of the options and warrants due to insufficient exercise activity during recent years as a basis from which to estimate future exercise patterns. The expected dividend assumption is based on the Company's history and expectation of dividend payouts.

Forfeitures are required to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

For stock option awards for which vesting is contingent upon the achievement of certain performance targets, the timing and amount of compensation expense recognized is based upon the Company's projections and estimates of the relevant performance metric(s).

Stock Options

Options granted under the Plan expire at various times – either five, seven, or ten years from the date of grant, depending on the particular grant.

On March 1, 2016, the Company granted options to purchase an aggregate of 100,000 shares of common stock to a member of management. The exercise price of the options is \$7.00 per share, and one-third of the options will vest on each of December 31, 2016, December 31, 2017, and March 31, 2018.

On March 31, 2016, the Company granted options to purchase an aggregate of 1,671,500 shares of common stock to certain executives, non-executive management, and employees. The exercise price of the options is \$5.80 per share, and one-third of the options will vest on each of March 31, 2017, March 31, 2018, and March 31, 2019.

On March 31, 2016, the Company granted options to purchase an aggregate of 500,000 shares of common stock to certain key employees. The exercise price for 100,000 of these options is \$5.80 per share, and such options will vest on January 1, 2017. The exercise price of the remaining 400,000 options is \$7.50 per share, and the vesting of such options is dependent upon the achievement of certain royalty income targets.

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On March 31, 2016, the Company granted options to purchase an aggregate of 150,000 shares of common stock to non-management directors. The exercise price of the options is \$5.80 per share, and 50% of the options will vest on each of March 31, 2017 and March 31, 2018.

On August 11, 2016, the Company granted options to purchase an aggregate of 25,000 shares of common stock to a newly appointed non-management director. The exercise price of the options is \$5.15 per share, and 50% of the options will vest on each of August 31, 2017 and August 31, 2018.

The fair values of the options granted during the Current Nine Months were estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

Expected Volatility	33.25 – 34.85%
Expected Dividend Yield	0%
Expected Life (Term)	3.25 – 5.32 years
Risk-Free Interest Rate	0.91 – 1.21%

A summary of the Company's stock options activity for the Current Nine Months is as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2016	379,500	\$ 5.50	1.71	\$ 1,174,000
Granted	2,446,500	6.12		
Canceled	-	-		
Exercised	(13,000)	3.08		
Expired/Forfeited	(36,000)	5.22		
Outstanding at September 30, 2016, and expected to vest	<u>2,777,000</u>	<u>\$ 6.06</u>	<u>4.34</u>	<u>\$ -</u>
Exercisable at September 30, 2016	<u>354,000</u>	<u>\$ 5.58</u>	<u>0.83</u>	<u>\$ -</u>

Compensation expense related to stock options for the Current Quarter and the Prior Year Quarter was approximately \$296,000 and \$17,000, respectively. Compensation expense related to stock option grants for the Current Nine Months and the Prior Year Nine Months was \$644,000 and \$50,000, respectively. Total unrecognized compensation expense related to unvested stock options at September 30, 2016 amounts to \$2,899,000 and is expected to be recognized over a weighted average period of 2.88 years.

The following table summarizes the Company's stock option activity for non-vested options for the Current Nine Months:

	Number of Options	Weighted Average Grant Date Fair Value
Balance at January 1, 2016	47,500	\$ 1.43
Granted	2,446,500	1.44
Vested	(42,500)	1.42
Forfeited or Canceled	(28,500)	1.49
Balance at September 30, 2016	<u>2,423,000</u>	<u>\$ 1.44</u>

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Warrants

Warrants granted under the Plan expire at various times, either five, seven or ten years from the date of grant, depending on the particular grant.

A summary of the Company's warrants activity for the Current Nine Months is as follows:

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value
Outstanding and exercisable at January 1, 2016	2,219,543	\$ 6.07	3.23	\$ 3,168,000
Granted	-	-		
Canceled	-	-		
Exercised	(218,000)	0.01		
Expired/Forfeited	(34,800)	5.14		
Outstanding and exercisable at September 30, 2016	<u>1,966,743</u>	<u>\$ 6.76</u>	<u>3.06</u>	<u>\$ -</u>

No compensation expense was recognized in the Current Nine Months or Prior Year Nine Months related to warrants.

Restricted Stock

On March 31, 2016, the Company issued to a key employee 17,242 shares of restricted stock. The shares of restricted stock vested over six months.

On March 31, 2016, the Company issued to a member of management 50,000 shares of restricted stock. The shares of restricted stock vest evenly over 4 years, whereby 25% shall vest on each of March 31, 2017, March 31, 2018, March 31, 2019, and March 31, 2020.

On March 31, 2016, the Company issued to certain executives an aggregate of 150,001 shares of restricted stock. The shares of restricted stock vest evenly over three years, whereby one-third shall vest on each of March 31, 2017, March 31, 2018, and March 31, 2019.

On March 31, 2016, the Company issued to non-management directors an aggregate of 48,000 shares of restricted stock. The shares of restricted stock will vest evenly over two years, whereby 50% shall vest on March 31, 2017 and 50% shall vest on March 31, 2018.

On August 11, 2016, the Company issued to a newly appointed non-management director an aggregate of 8,000 shares of restricted stock. The shares of restricted stock will vest evenly over two years, whereby 50% shall vest on August 31, 2017 and 50% shall vest on August 31, 2018.

Notwithstanding the foregoing, each grantee may extend the first anniversary of all or a portion of the restricted stock by six months and, thereafter one or more times may further extend such date with respect to all or a portion of the restricted stock until the next following September 30th or March 31st, as the case may be, by providing written notice of such election to extend such date with respect to all or a portion of the restricted stock prior to such date.

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A summary of the Company's restricted stock activity for the Current Nine Months is as follows:

	Number of Restricted Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2016	3,530,485	\$ 4.95
Granted	273,243	5.78
Canceled	-	-
Vested	(539,900)	4.44
Expired/Forfeited	(12,275)	8.66
Outstanding at September 30, 2016	<u>3,251,553</u>	<u>\$ 5.09</u>

Compensation expense related to restricted stock grants for the Current Quarter and Prior Year Quarter was \$793,000 and \$1,275,000, respectively. Compensation expense related to restricted stock grants for the Current Nine Months and Prior Year Nine Months was \$3,110,000 and \$3,363,000, respectively.

Total unrecognized compensation expense related to unvested restricted stock grants at September 30, 2016 amounts to \$2,819,000 and is expected to be recognized over a weighted average period of 1.56 years.

Shares Available Under the Company's 2011 Equity Incentive Plan

At September 30, 2016, there were 5,743,263 shares of common stock available for issuance under the Plan.

Shares Reserved for Issuance

At September 30, 2016, there were 10,487,006 shares of common stock reserved for issuance pursuant to unexercised warrants and stock options, or available for issuance under the Plan.

Dividends

The Company has not paid any dividends to date.

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6. Earnings Per Share

Basic earnings per share (“EPS”) is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS gives effect to all potentially dilutive common shares outstanding during the period, including stock options and warrants, using the treasury stock method. Diluted EPS excludes all potentially dilutive shares of common stock if their effect is anti-dilutive.

Shares used in calculating basic and diluted income (loss) per share are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Basic	18,692,775	17,187,272	18,608,034	15,380,609
Effect of exercise of warrants	369,288	962,292	-	962,292
Effect of exercise of stock options	5,948	128,618	-	128,618
Diluted	<u>19,068,011</u>	<u>18,278,182</u>	<u>18,608,034</u>	<u>16,471,519</u>

As a result of the net loss from continuing operations presented for the nine months ended September 30, 2016, the Company calculated diluted earnings per share using basic weighted-average shares outstanding for those periods, as utilizing diluted shares would be anti-dilutive to loss per share.

The computation of diluted EPS excludes the common stock equivalents of the following potentially dilutive securities because their inclusion would be anti-dilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Stock options and warrants	3,338,000	750,000	4,743,743	750,000

7. Income Tax

The effective income tax rate for the Current Quarter and the Prior Year Quarter from continuing operations was approximately 68% and 54%, respectively, resulting in a \$256,000 income tax provision and a \$51,000 income tax provision, respectively.

The effective income tax rate for the Current Nine Months and the Prior Year Nine Months was approximately 15% and 2%, respectively, resulting in a \$3,000 income tax benefit and a \$35,000 income tax provision, respectively.

During the Current Quarter and the Current Nine Months, the respective effective tax rates were attributable to recurring permanent differences. Based on the amount of income/(loss) from continuing operations before income taxes compared to the permanent differences, the effective rate increased by 27% and decreased by 26% for the Current Quarter and the Current Nine Months, respectively.

For the Prior Year Nine Months, the Company recorded a \$3.00 million gain on the reduction of contingent obligations related to the acquisition of the Isaac Mizrahi Brand, partially offset by recurring permanent differences. This gain was not subject to tax and was therefore treated as a discrete item (permanent difference) occurring in the Prior Year Nine Months. Based on the amount of income from continuing operations before income taxes compared to the permanent differences, the effective rate increased by 13% and decreased by 39% for the Prior Year Quarter and the Prior Year Nine Months, respectively.

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8. Discontinued Operations

Discontinued operations represent the net sales and expenses related to the Company's retail operations, which were discontinued in December 2014. A summary of the results of discontinued operations for the Current Quarter, Prior Year Quarter, Current Nine Months, and Prior Year Nine Months is as follows (in thousands, except share and per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	\$ -	\$ -	\$ -	\$ 287
Cost of sales	-	-	-	(221)
Operating expenses	-	(1)	-	(267)
Loss from disposal of discontinued operations	-	(32)	-	(273)
Income tax benefit	-	19	-	193
Loss from discontinued operations, net	<u>\$ -</u>	<u>\$ (14)</u>	<u>\$ -</u>	<u>\$ (281)</u>
Loss per share from discontinued operations, net:				
Basic	<u>\$ -</u>	<u>\$ (0.00)</u>	<u>\$ -</u>	<u>\$ (0.02)</u>
Diluted	<u>\$ -</u>	<u>\$ (0.00)</u>	<u>\$ -</u>	<u>\$ (0.02)</u>
Weighted average shares outstanding:				
Basic	<u>18,692,775</u>	<u>17,187,272</u>	<u>18,608,034</u>	<u>15,380,609</u>
Diluted	<u>19,068,011</u>	<u>18,278,182</u>	<u>18,608,034</u>	<u>16,471,519</u>

Assets and liabilities of discontinued operations were not material as of September 30, 2016 and December 31, 2015.

9. Related Party Transactions

Licensing Agent Agreement

On August 2, 2011, the Company entered into a licensing agent agreement with Adam Dweck, son of Jack Dweck, a former director of the Company, pursuant to which he is entitled to a five percent commission on any royalties the Company receives under any new license agreements that he procures for the Company for the initial term of such license agreements. Adam Dweck earned approximately \$0 and \$0 in fees for the Current Quarter and Prior Year Quarter, respectively, and earned approximately \$1,000 and \$11,000 in fees for the Current Nine Months and Prior Year Nine Months, respectively.

Todd Slater

On September 29, 2011, the Company entered into an agreement, which was amended on October 4, 2011 and on July 10, 2012, with Todd Slater, who was a director of the Company from October 17, 2011 through August 9, 2016, for services related to the Company's licensing strategy and introduction to potential licensees. In July 2012, the Company made a one-time payment to Mr. Slater of \$163,000 in connection with the amendment. The Company incurred direct licensing costs with Mr. Slater from amortization of the one-time payment for the Prior Year Quarter and Prior Year Nine Months of \$16,000 and \$32,000, respectively.

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Benjamin Malka

The Company entered into a license agreement with The H Company IP, LLC (“HIP”) on December 22, 2014, which was amended September 1, 2015. Benjamin Malka, a director of the Company, is a 25% equity holder of HIP’s parent company, House of Halston LLC (“HOH”), and Chief Executive Officer of HOH. The HIP license agreement provides for royalty payments including guaranteed minimum royalties to be paid to the Company during the initial term that expires on December 31, 2019.

On September 1, 2015 the Company entered into a license agreement with Lord and Taylor, LLC (the “L&T License”) and simultaneously amended the H Halston License Agreement eliminating HIP’s minimum guaranteed royalty obligations, provided the L&T License is in effect. In addition, the Company entered into a sublicense agreement with HIP obligating the Company to pay HIP a royalty participation fee on an annual basis the greater of (i) 50% of royalties received under the L&T License or (ii) guaranteed minimum royalties. Guaranteed minimum royalties are equal to \$0.25 million for the seventeen months ending January 31, 2017, and \$0.75 million, \$0.75 million, \$1.5 million, and \$1.75 million for the twelve months ending January 31, 2018, 2019, 2020, and 2021, respectively.

The Company incurred a \$28,000 and \$15,000 royalty participation fee with HIP for the Current Year Quarter and the Prior Year Quarter, respectively. The Company incurred a \$91,000 and \$15,000 royalty participation fee with HIP for the Current Nine Months and the Prior Year Nine Months, respectively.

HOH has also entered into an arrangement with another licensee of the Company to supply Halston-branded apparel for the subsequent sale of such product to end customers. Under the Company’s separate pre-existing licensing agreements in place with the aforementioned other licensee and with HIP as described above, the Company earns royalties on the sales of such Halston-branded products.

Edward Jones, III

On May 14, 2015, and amended on June 24, 2015, the Company entered into a consulting agreement with Jones Texas, Inc., (“JT Inc.”) whose controlling shareholder is Edward Jones, a director of the Company. The agreement, as amended, provided for fees payable to JT Inc. up to \$75,000 for consulting services related to due diligence on the C Wonder brand prior to acquisition. The Company paid fees to JT Inc. of \$62,500 and \$75,000 during the Prior Year Quarter and Prior Year Nine Months.

During the Current Nine Months, Edward Jones performed consulting services for and received compensation from a certain licensee of the Company (the “Licensee”). Under the terms of the Company’s agreement with the Licensee, the Licensee may supply the Company’s branded products to our other licensees. Under the terms of the Company’s separate pre-existing agreements with other licensees, the Company would earn royalties on the sales of such branded products sold to end customers. To date, the Company has not earned or received any fees or revenues related to the Company’s agreement with the Licensee, but may earn or receive such amounts in the future.

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10. Facility Exit Costs

In June 2016, the Company relocated its corporate offices and operations from 475 Tenth Avenue in New York City to 1333 Broadway in New York City. In connection with the exit from its former office location, the Company recognized a liability at the exit and cease-use date for the remaining lease obligation associated with 475 Tenth Avenue, based on the remaining contractual lease payments less estimated sublease rentals, discounted to present value using a credit-adjusted risk-free rate.

The Company recorded a net non-cash charge of approximately \$648,000 associated with the recognition of this liability. The Company also incurred certain cash costs of approximately \$15,000 related to the exit from its former office space, and incurred a loss of approximately \$7,000 associated with the sale of certain equipment. These amounts, totaling approximately \$670,000, were recorded as other selling, general and administrative expenses in the accompanying unaudited condensed consolidated statements of operations for nine months ended September 30, 2016.

During the Current Quarter, the Company made net cash payments related to 475 Tenth Avenue of \$166,000, and recorded \$6,000 of accretion expense related to the exit cost liability as other selling, general and administrative expenses.

The remaining balance of the exit cost liability related to the former office space was approximately \$780,000 as of September 30, 2016, of which \$149,000 was recorded in other current liabilities and \$631,000 was recorded in other long-term liabilities in the accompanying unaudited condensed consolidated balance sheets. The balance of this liability will be paid out over a period of approximately 5 years, through February 2022.

A summary of the activity related to the exit cost liability for the Current Nine Months is as follows:

(\$ in thousands)	
Balance as of January 1, 2016	\$ -
Non-cash costs incurred and charged to expense	648
Transfers of previously-recognized deferred balance sheet amounts related to lease	333
Cash payments, net	(207)
Accretion	6
Balance as of September 30, 2016	\$ <u>780</u>

11. Subsequent Events

On October 31, 2016, the Company granted options to purchase an aggregate of 150,000 shares of common stock to three independent directors. The exercise price of the options is \$5.00 per share, and 50% of the options will vest on each of October 31, 2017 and October 31, 2018. The options will expire on October 31, 2021.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995. The statements that are not historical facts contained in this report are forward-looking statements that involve a number of known and unknown risks, uncertainties and other factors, all of which are difficult or impossible to predict and many of which are beyond our control, which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These risks are detailed in the Risk Section of our Form 10-K for the fiscal year ended December 31, 2015. The words “believe,” “anticipate,” “expect,” “continue,” “estimate,” “appear,” “suggest,” “goal,” “potential,” “predicts,” “seek,” “will,” “confident,” “project,” “provide,” “plan,” “likely,” “future,” “ongoing,” “intend,” “may,” “should,” “would,” “could,” “guidance,” and similar expressions identify forward-looking statements.

Overview

Xcel Brands, Inc. (“Xcel,” the “Company,” “we,” “us” or “our”) is a brand management and media company engaged in the design, production, licensing, marketing, and direct to consumer sales of branded apparel, footwear, accessories, jewelry, home goods, and other consumer products, and the acquisition of dynamic consumer lifestyle brands. Currently, our brand portfolio consists of the Isaac Mizrahi, Judith Ripka, H Halston, C Wonder, and the Highline Collective brands. We also managed and designed the Liz Claiborne New York brand (“LCNY Brand”) through July 31, 2016. Going forward, our focus shall be on our wholly owned brands.

Our objective is to build a diversified portfolio of lifestyle consumer brands through organic growth and the strategic acquisition of new brands. To achieve growth under our brands, we are focused on two primary licensing and design activities:

- licensing our brands for distribution through interactive television (i.e. QVC and The Shopping Channel); and
- licensing our brands to manufacturers and retailers for promotion and distribution through e-commerce, social commerce, and traditional brick-and-mortar retail channels.

We believe that Xcel offers a unique value proposition to its licensees and customers for the following reasons:

- our management team, including our officers’ and directors’ historical track records and relationships within the industry;
- our brand management platform, which has a strong focus on design, production, marketing, and social media; and
- our operating strategy of licensing brands with significant media presence and driving sales through our ubiquitous-channel retail sales strategy across interactive television, internet and traditional retail channels.

We license our brands to third parties, provide certain design, production, and marketing services, and generate royalty design and service fee revenues through licensing and other agreements with manufacturers and retailers. This includes licensing our own brands for promotion and distribution through a ubiquitous-channel retail sales strategy, which includes distribution through interactive television, the internet, and traditional brick-and-mortar retail channels. We believe that this strategy distinguishes us from other brand management companies that rely primarily on their licensees for design, production and distribution, and enables us to leverage the media reach of our interactive television partners, including through television, digital and social media, to drive sales of products under our brands across distribution channels.

Our vision is intended to reimagine shopping, entertainment, and social as one. By leveraging digital and social media content across all distribution channels, we seek to drive customer (follower) engagement and generate retail sales across our brands. Our strong relationships with leading retailers and interactive television companies, such as QVC and The Shopping Channel, enable us to reach consumers in over 350 million homes worldwide.

We believe our “virtual vertical” production platform provides significant competitive advantages compared with traditional wholesale apparel companies that design, manufacture, and distribute products. We remain focused on our core competencies of licensing, production, design, marketing and brand development, while outsourcing manufacturing and the related inventory ownership to best-in-class partners. We believe that we offer 360 degrees of service for a comprehensive solution for our retail partners that addresses many of the challenges facing the retail industry today. We believe our platform is highly scalable due to our business model’s low overhead and working capital requirements, coupled with minimum guaranteed income levels through our multi-year licensing contracts. Additionally, we believe we can quickly integrate additional brands into our platform in order to leverage our design, production oversight, and marketing capabilities and retail and licensee relationships.

We opened a full-price store and an outlet store under the Isaac Mizrahi brand in 2013 and 2014, respectively. In December 2014, we decided to close our retail stores. Accordingly, our retail operations have been classified as discontinued operations for all periods presented.

Our e-commerce operations, which were previously reported as a component of retail operations, are reported as a component of our licensing business. E-commerce operations are in the process of being phased out.

Summary of Operating Results

The three months ended September 30, 2016 (the “Current Quarter”) compared with the three months ended September 30, 2015 (the “Prior Year Quarter”)

Total Revenues

Current Quarter total revenues increased approximately \$0.99 million to \$8.33 million from \$7.34 million in the Prior Year Quarter. This increase was attributable to increases in net licensing revenues of approximately \$1.02 million, partially offset by declines in net e-commerce sales of \$0.03 million.

The increase in net licensing revenues for the Current Quarter as compared with the Prior Year Quarter was primarily due to (i) higher revenues from our interactive television business of approximately \$1.13 million, driven by acquisitions made in late 2014 and 2015, and (ii) increased revenues recognized from new strategic license agreements entered into in 2015 and 2016 of approximately \$0.31 million. These increases were partially offset by a decrease in revenue of approximately \$0.42 million associated with the management and design of the LCNV brand, for which our contract ended in July 2016.

The decline in net e-commerce sales from the Prior Year Quarter is the result of management’s decision to phase out of e-commerce.

Gross Profit

Gross profit for the Current Quarter was \$8.29 million, compared with \$7.29 million for the Prior Year Quarter. The increase in gross profit was primarily attributable to the increase in net licensing revenues described above.

Operating Expenses

Operating expenses totaled \$7.45 million for the Current Quarter, compared with \$6.76 million for the Prior Year Quarter. The increase of approximately \$0.69 million was primarily due to an increase in salaries, benefits and employment taxes, largely driven by increased staffing to support ongoing growth in our brand portfolio, as well as the scaling of our operations and infrastructure to support the ongoing growth of our business.

Interest and Finance Expense

Interest and finance expense for the Current Quarter increased by approximately \$0.03 million to \$0.46 million, compared with \$0.43 million in the Prior Year Quarter. This increase was primarily due to the higher interest rate on our term debt following the February 2016 refinancing (the term debt interest rate was converted from a variable rate of approximately 4.1% to a fixed rate of 5.1%).

Income Tax Provision

The effective income tax rate for the Current Quarter was approximately 68% resulting in a \$0.26 million income tax provision. During the Current Quarter, the effective tax rate was attributable to recurring permanent differences. Based on the amount of income from continuing operations before income taxes compared to the permanent differences, the effective rate increased by 27%.

The effective income tax rate for the Prior Year Quarter was approximately 54% which resulted in a \$0.05 million income tax provision. For the Prior Year Quarter, the effective tax rate was attributable to recurring permanent differences. Based on the amount of income from continuing operations before income taxes compared to the permanent differences, the effective rate decreased by 13%.

Discontinued Operations

The loss from discontinued operations, net of \$0.01 million in the Prior Year Quarter was related to our retail operations and was primarily attributable to wind down costs associated with the closing of our retail stores. As these wind down and closure activities were essentially completed by the end of 2015, we had no such costs reported as discontinued operations in the Current Quarter.

Net Income (Loss)

The Company had net income of \$0.12 million for the Current Quarter, compared with net income of \$0.03 million for the Prior Year Quarter.

Non-GAAP Net Income, Non-GAAP Diluted EPS, and Adjusted EBITDA

The Company had non-GAAP net income of \$1.29 million, or \$0.07 per diluted share ("non-GAAP diluted EPS") for the Current Quarter, compared with non-GAAP net income of \$1.42 million, or non-GAAP diluted EPS of \$0.08 for the Prior Year Quarter. Non-GAAP net income is a non-GAAP unaudited term, which we define as net income (loss), exclusive of stock-based compensation, non-cash interest expense from discounted debt related to acquired assets, gain on the reduction of contingent obligations (if any), loss on extinguishment of debt (if any), non-recurring facility exit charges, and net loss from discontinued operations. Non-GAAP net income and non-GAAP diluted EPS measures do not include the tax effect of the aforementioned adjusting items, due to the nature of these items and the Company's tax strategy.

The Company had Adjusted EBITDA of \$2.34 million for the Current Quarter, compared with Adjusted EBITDA of \$2.22 million for the Prior Year Quarter. Adjusted EBITDA is a non-GAAP unaudited measure, which we define as net income (loss) before stock-based compensation, interest expense and other financing costs (including gain (loss) on extinguishment of debt), income taxes, other state and local franchise taxes, depreciation and amortization, gain on the reduction of contingent obligations, non-recurring facility exit charges, and net loss from discontinued operations.

Management uses non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA as measures of operating performance to assist in comparing performance from period to period on a consistent basis and to identify business trends relating to the Company's results of operations. Management believes Non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA are also useful because they provide supplemental information to assist investors in evaluating the Company's financial results.

Non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA should not be considered in isolation or as alternatives to net income, earnings per share, or any other measure of financial performance calculated and presented in accordance with GAAP. Given that non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA are financial measures not deemed to be in accordance with GAAP and are susceptible to varying calculations, our non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA may not be comparable to similarly titled measures of other companies, including companies in our industry, because other companies may calculate non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA in a different manner than we calculate these measures.

In evaluating non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA, you should be aware that in the future we may or may not incur expenses similar to some of the adjustments in this report. Our presentation of non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA does not imply that our future results will be unaffected by these expenses or any unusual or non-recurring items. When evaluating our performance, you should consider non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA alongside other financial performance measures, including our net income and other GAAP results, and not rely on any single financial measure.

The following table is a reconciliation of net income (our most directly comparable financial measure presented in accordance with GAAP) to non-GAAP net income:

(\$ in thousands)	Three Months Ended September 30,	
	2016	2015
Net income	\$ 118	\$ 30
Non-cash interest and finance expense	78	84
Stock-based compensation	1,089	1,292
Loss from discontinued operations, net	-	14
Non-GAAP net income	\$ 1,285	\$ 1,420

The following table is a reconciliation of diluted earnings per share to non-GAAP diluted EPS:

	Three Months Ended September 30,	
	2016	2015
Diluted earnings per share	\$ 0.01	\$ 0.00
Non-cash interest and finance expense	-	0.01
Stock-based compensation	0.06	0.07
Loss from discontinued operations, net	-	-
Non-GAAP diluted EPS	\$ 0.07	\$ 0.08
Non-GAAP weighted average diluted shares	19,068,011	18,278,182

The following table is a reconciliation of basic weighted average shares to non-GAAP weighted average diluted shares:

	Three Months Ended September 30,	
	2016	2015
Basic weighted average shares	18,692,775	17,187,272
Effect of exercising warrants	369,288	962,292
Effect of exercising stock options	5,948	128,618
Non-GAAP weighted average diluted shares	19,068,011	18,278,182

The following table is a reconciliation of net income (our most directly comparable financial measure presented in accordance with GAAP) to Adjusted EBITDA:

(\$ in thousands)	Three Months Ended September 30,	
	2016	2015
Net income	\$ 118	\$ 30
Depreciation and amortization	387	373
Interest and finance expense	462	432
Income tax provision	256	51
State and local franchise taxes	26	27
Stock-based compensation	1,089	1,292
Loss from discontinued operations, net	-	14
Adjusted EBITDA	\$ 2,338	\$ 2,219

The nine months ended September 30, 2016 (the “Current Nine Months”) compared with the nine months ended September 30, 2015 (the “Prior Year Nine Months”)

Total Revenues

Current Nine Months total revenues increased approximately \$5.59 million to \$25.84 million from \$20.25 million in the Prior Year Nine Months. This increase was attributable to increases in net licensing revenues of approximately \$5.67 million, partially offset by declines in net e-commerce sales of \$0.08 million.

The increase in net licensing revenues for the Current Nine Months as compared with the Prior Year Nine Months was primarily due to (i) higher revenues from our interactive television business of approximately \$5.20 million, driven by acquisitions made in late 2014 and 2015, and (ii) increased revenues recognized from new strategic license agreements entered into in 2015 and 2016 of approximately \$1.35 million. These increases were partially offset by a decrease in revenue of approximately \$0.88 associated with the management and design of the LCNV brand, for which our contract ended in July 2016.

The decline in net e-commerce sales from the Prior Year Nine Months is the result of management’s decision to phase out of e-commerce.

Gross Profit

Gross profit for the Current Nine Months was \$25.69 million, compared with \$20.12 million for the Prior Year Nine Months. The increase in gross profit was primarily attributable to the increase in net licensing revenues described above.

Operating Expenses

Operating expenses totaled \$24.29 million for the Current Nine Months, compared with \$18.25 million for the Prior Year Nine Months. The increase of approximately \$6.04 million was primarily related to an increase in compensation-related expenses (including stock-based compensation) of approximately \$3.18 million, an increase in design and marketing costs of approximately \$0.68 million, and an increase in other selling, general and administrative expenses of approximately \$1.96 million, which included non-recurring charges of \$0.67 million incurred in the Current Nine Months in connection with the exit from our former leased office facilities. These increases in expenses were the result of increased staffing and scaling of our operations and infrastructure in order to support (i) the C Wonder Brand, which we acquired in July 2015 and which began selling on QVC in March 2016, (ii) the development and operation of our quick-time-response or short lead time “virtual vertical” production platform, and (iii) launch and related ramp-up of the IMNYC Isaac Mizrahi, H Halston, and Highline Collective brands at Lord & Taylor and Hudson’s Bay department stores in April 2016.

The increase in depreciation and amortization expense of approximately \$0.22 million was primarily related to the amortization of the C Wonder trademarks acquired in July 2015, partially offset by certain other intangible assets becoming fully amortized in 2015 (see Note 2 in the Unaudited Condensed Consolidated Financial Statements).

Other Expenses (Income)

Total other income, net of \$1.63 million for the Prior Year Nine Months was comprised of a \$3.00 million gain on the reduction of contingent obligations, partially offset by a \$1.37 million loss on extinguishment of debt.

The gain on the reduction of contingent obligations in the Prior Year Nine Months was a result of the Company reducing the fair value of its contingent obligation on its earn-out obligation to the seller of the Isaac Mizrahi Brand.

The loss on extinguishment of debt in the Prior Year Nine Months was a result of the Company satisfying \$5.40 million principal amount of Ripka Seller Notes by issuing 600,001 shares of our common stock in March and April 2015. The carrying value, net of the discount, of the Ripka Seller Notes at the redemption date was \$4.03 million, resulting in a loss of \$1.37 million.

Interest and Finance Expense

Interest and finance expense for the Current Nine Months increased by approximately \$0.05 million to \$1.43 million, compared with \$1.38 million in the Prior Year Nine Months. This increase was primarily due to the higher interest rate on our term debt following the February 2016 refinancing (as the term debt interest rate was converted from a variable rate of approximately 4.1% to a fixed rate of 5.1%) and fees associated with the refinancing, largely offset by lower interest expense following the satisfaction of \$5.40 million principal amount of the Ripka Seller Notes in March 2015 and April 2015.

Income Tax (Benefit) Provision

The effective income tax rate for the Current Nine Months was approximately 15% resulting in a \$0.003 million income tax benefit. During the Current Nine Months, the effective tax rate was attributable to recurring permanent differences. Based on the amount of loss from continuing operations before income taxes compared to the permanent differences, the effective rate decreased by 26%.

The effective income tax rate for the Prior Year Nine Months was approximately 2% which resulted in a \$0.04 million income tax provision. For the Prior Year Nine Months, the Company recorded a \$3.00 million gain on the reduction of contingent obligations related to the acquisition of the Isaac Mizrahi Brand, partially offset by recurring permanent differences. This gain was not subject to tax and was therefore treated as a discrete item (permanent difference) occurring in the Prior Year Nine Months. Based on the amount of income from continuing operations before income taxes compared to the permanent differences, the effective rate decreased by 39%.

Discontinued Operations

The loss from discontinued operations, net of \$0.28 million in the Prior Year Nine Months was related to our retail operations and was primarily attributable to compensation expense, other general and administrative expenses, and wind down costs associated with the closing of our retail stores, partially offset by an income tax benefit of \$0.19 million. As these wind down and closure activities were essentially completed by the end of 2015, we had no such costs reported as discontinued operations in the Current Nine Months.

Net (Loss) Income

The Company had a net loss of \$0.02 million for the Current Nine Months, compared with net income of \$1.81 million for the Prior Year Nine Months.

Non-GAAP Net Income, Non-GAAP Diluted EPS, and Adjusted EBITDA

The Company had non-GAAP net income of \$4.64 million, or \$0.24 per diluted share for the Current Nine Months, compared with non-GAAP net income of \$4.20 million, or non-GAAP diluted EPS of \$0.26 for the Prior Year Nine Months. The Company had Adjusted EBITDA of \$7.08 million for the Current Nine Months, compared with Adjusted EBITDA of \$6.32 million for the Prior Year Nine Months.

The following table is a reconciliation of net (loss) income (our most directly comparable financial measure presented in accordance with GAAP) to non-GAAP net income:

(\$ in thousands)	Nine Months Ended September 30,	
	2016	2015
Net (loss) income	\$ (17)	\$ 1,806
Non-cash interest and finance expense	236	330
Stock-based compensation	3,754	3,413
Loss on extinguishment of debt	-	1,371
Gain on reduction of contingent obligations	-	(3,000)
Non-recurring facility exit charges	670	-
Loss from discontinued operations, net	-	281
Non-GAAP net income	\$ 4,643	\$ 4,201

The following table is a reconciliation of diluted (loss) earnings per share to non-GAAP diluted EPS:

	Nine Months Ended September 30,	
	2016	2015
Diluted (loss) earnings per share	\$ (0.00)	\$ 0.11
Non-cash interest and finance expense	0.01	0.02
Stock-based compensation	0.20	0.21
Loss on extinguishment of debt	-	0.08
Gain on reduction of contingent obligations		(0.18)
Non-recurring facility exit charges	0.03	-
Loss from discontinued operations, net	-	0.02
Non-GAAP diluted EPS	<u>\$ 0.24</u>	<u>\$ 0.26</u>
Non-GAAP weighted average diluted shares	<u>19,071,332</u>	<u>16,471,519</u>

The following table is a reconciliation of basic weighted average shares to non-GAAP weighted average diluted shares:

	Nine Months Ended September 30,	
	2016	2015
Basic weighted average shares	18,608,034	15,380,609
Effect of exercising warrants	435,298	962,292
Effect of exercising stock options	28,000	128,618
Non-GAAP weighted average diluted shares	<u>19,071,332</u>	<u>16,471,519</u>

The following table is a reconciliation of net (loss) income (our most directly comparable financial measure presented in accordance with GAAP) to Adjusted EBITDA:

(\$ in thousands)	Nine Months Ended September 30,	
	2016	2015
Net (loss) income	\$ (17)	\$ 1,806
Depreciation and amortization	1,172	953
Interest and finance expense	1,427	1,376
Income tax (benefit) provision	(3)	35
State and local franchise taxes	75	83
Stock-based compensation	3,754	3,413
Loss on extinguishment of debt	-	1,371
Gain on reduction of contingent obligations	-	(3,000)
Non-recurring facility exit charges	670	-
Loss from discontinued operations, net	-	281
Adjusted EBITDA	<u>\$ 7,078</u>	<u>\$ 6,318</u>

Liquidity and Capital Resources

Liquidity

Our principal capital requirements have been to fund working capital needs, acquire new brands, and to a lesser extent, capital expenditures. At September 30, 2016 and December 31, 2015, our unrestricted cash and cash equivalents were \$15.16 million and \$16.86 million, respectively.

We expect that existing cash and operating cash flows will be adequate to meet our operating needs, debt service obligations (including debt service under the Loan Agreement), and capital expenditure needs, for at least the twelve months subsequent to September 30, 2016. We are dependent on our licensees for most of our revenues, and there is no assurance that the licensees will perform as projected.

Our business operating model generally does not require significant capital expenditures.

Our contingent obligations (see Note 4, Debt in the Unaudited Condensed Consolidated Financial Statements) are payable in stock or cash, at the Company's discretion. Payment of these obligations in stock would not affect our liquidity.

Changes in Working Capital

At September 30, 2016 and December 31, 2015, our adjusted working capital (current assets less current liabilities, excluding current contingent obligations and seller notes payable in stock (see Note 4, Debt in the Unaudited Condensed Consolidated Financial Statements)) was \$14.43 million and \$16.14 million, respectively. Commentary on the components of our cash flows used in continuing operations for the Current Nine Months as compared with the Prior Year Nine Months is set forth below.

Operating Activities

Net cash provided by operating activities from continuing operations was approximately \$6.77 million in the Current Nine Months, compared with net cash provided by operating activities from continuing operations of approximately \$1.29 million in the Prior Year Nine Months.

The Current Nine Months' cash provided by operating activities was due to the combination of a net loss of \$(0.02) million, non-cash expenses of \$5.95 million, and the net change in operating assets and liabilities of \$0.84 million. Non-cash expenses mainly consisted of \$3.75 million of stock-based compensation, \$1.17 million of depreciation and amortization, \$0.38 million of amortization of debt discount and deferred finance costs, and a non-cash charge of \$0.65 million related to the exit from our former leased office facilities. The net change in operating assets and liabilities includes an increase in accounts payable, accrued expenses and other current liabilities of \$1.31 million, largely due to withholding taxes payable related to shares surrendered for taxes on vested stock awards; and an increase in other liabilities of \$1.13 million related to the lease of our new corporate offices and operations facility, and the sublease of our former offices; partially offset by an increase in accounts receivable of \$1.21 million, primarily attributable to the increase in revenues.

The Prior Year Nine Months' cash provided by operating activities was comprised of net income of \$1.81 million, non-cash expenses of \$3.08 million, and a net loss from discontinued operations, net of \$0.28 million, partially offset by the change in operating assets and liabilities of \$(3.88) million. Non-cash expenses mainly consisted of \$3.41 million of stock-based compensation, \$1.37 million of loss from the extinguishment of debt, \$0.95 million of depreciation and amortization, \$(3.0) million of gain from the reduction of contingent obligations, \$(0.09) million deferred income tax benefit, and \$0.45 million of amortization of debt discount and deferred finance costs. The \$(3.88) million change in operating assets and liabilities includes an increase of \$3.83 million of accounts receivable primarily related to timing of collections from QVC, including \$1.47 million of earned revenue that had been accrued but not billed as of September 30, 2015.

Net cash provided by operating activities from discontinued operations in the Prior Year Nine Months was \$0.10 million.

Investing Activities

Net cash used in investing activities for the Current Nine Months was approximately \$2.34 million, compared with approximately \$4.81 million in the Prior Year Nine Months.

The Current Nine Months' net cash used in investing activities was primarily attributable to \$1.91 million of capital expenditures associated with leasehold improvements, furniture and fixtures, and equipment for our new corporate offices and operations facility, and \$0.40 million of restricted cash related to the security deposit of the subtenant at our former office facilities.

The Prior Year Nine Months' net cash used in investing activities was primarily attributable to restricted cash of \$1.11 million for a security deposit on the lease for our new office space, cash consideration paid for the acquisition of the C Wonder Brand of \$3.59 million, and capital expenditures of \$0.09 million.

Financing Activities

Net cash used in financing activities for the Current Nine Months was approximately \$6.13 million, compared with net cash provided by investing activities for the Prior Year Nine Months of approximately \$11.09 million.

Net cash used in financing activities for the Current Nine Months was primarily attributable to payments on our term debt obligations of \$3.13 million, payment on our IM Seller Note obligation of \$1.50 million, payment of the QVC Earn-Out obligation of \$0.25 million, shares repurchased including vested restricted stock in exchange for withholding taxes of \$1.21 million, and payment of deferred finance costs of \$0.07 million.

Net cash provided by financing activities for the Prior Year Nine Months was primarily attributable to the net proceeds from the issuance of our common stock of \$16.11 million, partially offset by repayments on our long-term debt of \$2.26 million, payment on our installment obligation related to the Ripka Brand of \$2.19 million, and \$0.71 million of repurchased shares of restricted stock that had vested.

Other Factors

We continue to seek to expand and diversify the types of licensed products being produced under our brands. We plan to continue to diversify the distribution channels within which licensed products are sold, in an effort to reduce dependence on any particular retailer, consumer, or market sector within each of our brands. The Mizrahi brand, H Halston brand, and C Wonder brand have a core business in fashion apparel and accessories. The Ripka brand historically has been focused on fine jewelry, which we believe helps diversify our industry focus while at the same time complements, expands on, and grows our overall business relationship with QVC. As of July 31, 2016, we no longer manage and design the Liz Claiborne New York brand. In April 2016, we brought the IMNYC Isaac Mizrahi, H Halston, and Highline Collective brands to Lord & Taylor and Hudson's Bay department stores through our quick-time-response direct-to-retail "virtual vertical" production platform, and plan to do the same with the C Wonder Limited brand next year. We also intend to seek new opportunities, including expansion through interactive television, our "virtual vertical" production platform, additional domestic and international licensing arrangements, and acquiring additional brands. Our success, however, will still remain largely dependent on our ability to build and maintain our brands' awareness and contract with and retain key licensees, as well as our licensees' ability to accurately predict upcoming fashion and design trends within their respective customer bases and fulfill the product requirements of their particular retail channels within the global marketplace. Unanticipated changes in consumer fashion preferences, slowdowns in the U.S. economy, changes in the prices of supplies, consolidation of retail establishments, and other factors noted in "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2015 as filed with the SEC could adversely affect our licensees' ability to meet and/or exceed their contractual commitments to us and thereby adversely affect our future operating results.

Effects of Inflation

We do not believe that the relatively moderate rates of inflation experienced over the past two years in the United States, where we primarily compete, have had a significant effect on revenues or profitability. If there were an adverse change in the rate of inflation by less than 10%, the expected effect on net income and cash flows would be immaterial.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, results of operations, or liquidity.

Critical Accounting Policies

The preparation of our unaudited condensed consolidated financial statements in conformity with GAAP requires management to exercise judgment. We exercise considerable judgment with respect to establishing sound accounting policies and in making estimates and assumptions that affect the reported amounts of our assets and liabilities, our recognition of revenues and expenses, and disclosure of commitments and contingencies at the date of the financial statements. We evaluate our estimates and judgments on an on-going basis. We base our estimates and judgments on a variety of factors, including our historical experience, knowledge of our business and industry and current and expected economic conditions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We periodically re-evaluate our estimates and assumptions with respect to these judgments and modify our approach when circumstances indicate that modifications are necessary. While we believe that the factors we evaluate provide us with a meaningful basis for establishing and applying sound accounting policies, we cannot guarantee that the results will always be accurate. Because the determination of these estimates requires the exercise of judgment, actual results could differ from such estimates.

Please refer to our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on March 17, 2016, for a discussion of our critical accounting policies. During the three and nine months ended September 30, 2016, there were no material changes to these policies.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable to smaller reporting companies.

ITEM 4. CONTROLS AND PROCEDURES

A. EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES:

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of September 30, 2016, the end of the period covered by this report. Based on, and as of the date of such evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of September 30, 2016 such that the information required to be disclosed in our SEC reports is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

B. CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING:

There have not been any significant changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of business, from time to time we become involved in legal claims and litigation. In the opinion of management, based on consultations with legal counsel, the disposition of litigation currently pending against us is unlikely to have, individually or in the aggregate, a materially adverse effect on our business, financial position or results of operations.

ITEM 1A. RISK FACTORS

We operate in a highly competitive industry that involves numerous known and unknown risks and uncertainties that could impact our operations. The risks described in Part I, Item 1A, "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2015 are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our financial condition and/or operating results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no sales of unregistered or registered securities during the nine months ended September 30, 2016.

The following table provides information with respect to shares of common stock we repurchased during the nine months ended September 30, 2016:

Period	Total Number of Shares Purchased	Average Price per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program
March 1, 2016 to March 31, 2016 (i)	52,000	5.80	-
September 1, 2016 to September 30, 2016 (i)	182,100	4.99	-
Total	234,100	\$ 5.17	-

- (i) The shares were exchanged from employees and directors in connection with the income tax withholding obligations on behalf of such employees and directors from the vesting of restricted stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The following exhibits are filed herewith:

- 31.1 Rule 13a-14(a)/15d-14(a) Certification (CEO)
- 31.2 Rule 13a-14(a)/15d-14(a) Certification (CFO)
- 32.1 Section 1350 Certification (CEO)
- 32.2 Section 1350 Certification (CFO)
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definitions Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 14, 2016

By: /s/ Robert W. D'Loren

Name: Robert W. D'Loren

Title: Chairman and Chief Executive Officer

By: /s/ James Haran

Name: James Haran

Title: Chief Financial Officer and Vice President

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Robert W. D'Loren certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended September 30, 2016 of Xcel Brands, Inc. (the "Company").
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 14, 2016

By: /s/ Robert W. D'Loren

Name: Robert W. D'Loren

Title: Chairman and Chief Executive Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James Haran certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended September 30, 2016 of Xcel Brands, Inc. (the "Company").
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 14, 2016

By: /s/ James Haran

Name: James Haran

Title: Chief Financial Officer and Vice President

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Xcel Brands, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert W. D'Loren certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

November 14, 2016

By: /s/ Robert W. D'Loren

Name: Robert W. D'Loren

Title: Chairman and Chief Executive Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Xcel Brands, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James Haran, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

November 14, 2016

By: /s/ James Haran

Name: James Haran

Title: Chief Financial Officer and Vice President
