Xcel Brands, Inc.

First Quarter 2016 Earnings Conference Call

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CORPORATE PARTICIPANTS

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James Haran, *Chief Financial Officer*

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CONFERENCE CALL PARTICIPANTS

Eric Beder, *Wunderlich Securities*

PRESENTATION

Operator:

Welcome to the Xcel Brands First Quarter 2016 Earnings Conference Call. Please be advised that reproduction of this call in full or in part is not permitted without prior written authorization of Xcel Brands, and as a reminder, this conference call is being recorded.

I would now like to turn the conference over to Hunter Wells of ICR. Thank you. Hunter, you may now begin.

Hunter Wells:

Good afternoon, everyone, and thank you for joining us. We appreciate your participation and interest. With us on the call today are Chairman and Chief Executive Officer, Robert D'Loren; Chief Financial Officer, Jim Haran; and EVP of Business Development and Treasury, Seth Burroughs.

By now, everyone should have access to the earnings release for the first quarter ended March 31, 2016, which went out today at approximately 4:00 p.m. Eastern time. In addition, the Company will file with the Securities and Exchange Commission its Annual Report on Form 10-Q for the three months ended March 31, 2016, no later than March 16, 2016. The release and the quarterly report shall be available on the Company's website at www.xcelbrands.com. This call is being webcast and a replay will be available on the Company's Investor Relations website.

Before we begin, please keep in mind that this call will contain forward-looking statements. All forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from certain expectations discussed here today. These risk factors are explained in detail in the Company's SEC filings. Xcel does not undertake any obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Finally, please note that on today's call, Management will refer to certain non-GAAP financial measures, such as non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA. The Company uses these non-GAAP metrics 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. The Company believes these financial performance measurements are also useful because they provide supplemental information to assist investors in evaluating the Company's financial results. These should not be considered in isolation or as an alternative to net income, earnings per share, or any other measure of financial performance calculated and presented in accordance with US GAAP. You may refer to the attachment to the Company's earnings release or to Part 1 Item 2 of the Form 10-Q for a reconciliation of non-GAAP measures.

Now, I'm pleased to introduce Robert D'Loren, Chairman and Chief Executive Officer. Bob, please go ahead.

Robert D'Loren:

Thanks, Hunter. Good afternoon, everyone, and thank you for joining us on today's call. I'd like to begin with an overview of our first quarter 2016 business performance, and then I will give some thoughts on our outlook for the balance of 2016 and beyond. Next, our CFO, Jim Haran, will discuss our financial results in more detail, and then finally, Jim, Seth, and I will open up the call for Q&A.

Okay, so let's start. We are encouraged by our strong start in fiscal 2016, which was propelled, one, by growth across all of our brands and the successful execution of our innovative business model. First quarter revenue increased 27% to $8.4 million. At the same time, our bottom line non-GAAP net income and Adjusted EBITDA for the quarter experienced slight declines from the prior year period. That said, this was in line with our expectations as we continued to make ongoing investments in setting up our Quick Time Response or short lead time production platform in connection with our strategic alliance with the Hudson's Bay Company. We are pleased with our first quarter results which illustrates our ability to increase our top line revenue while we make investments expected to better position us for future bottom line growth and increased shareholder value.

Also, our Management Team remains excited and optimistic about the prospects of the department store distribution channel with Hudson's Bay Company and other department store retailers. Before I provide an update on our ongoing initiatives and why we are strongly positioned for future success, I would like to share some highlights of the first quarter.

First, as I discussed on our previous earnings call, in February we refinanced our—and consolidated our senior credit facility with Bank Hapoalim. For those of you who are not aware, the new facility provides for simplified terms, amortization relief, a fixed 5-year interest rate of just over 5%, and the ability to issue dividends. Additionally, the new facility will provide us with increased flexibility and a long-term financing solution that will be essential in supporting our growing business.

Second, in March we launched C.Wonder on QVC and could not be more pleased with the results of this brand or with Brad Goreski, C.Wonder's Creative Director, and on-air personality. In addition to successfully bringing this whimsical brand forward, his ability to authentically engage with and entertain the QVC customer is very exciting.

International prospects with QVC are on track to launch C.Wonder in the UK, Italy, Germany, and France in the software of 2016. Looking ahead, we are excited to continue developing C.Wonder and are confident it will be an impressive growth driver in Xcel's future expansion across all of our distribution channels.

Third, in late April, the IMNYC Isaac Mizrahi, H. Halston and newly created Highline Collective Brands began selling in HBC's Lord & Taylor and The Bay department stores in the US and Canada through our QTR platform. Initial feedback has been encouraging with some wins on key sportswear and dress styles, and we are moving forward from startup stage to optimizing this platform. As we said before, we believe that this platform provides our department store partners with a virtual vertical production model based upon short lead production times that can drive customer traffic and increase full price sell-throughs. We could not be more excited about this new venture. We intend to continue to invest and grow this business with future goals leveraging the platform across multiple brands and retailers.

Fourth, our QVC business performed well across the Isaac Mizrahi line due to (inaudible) H. by Halston and C.Wonder brand. QVC remains an important and strategic partner for us and we continue to be excited by the significant opportunities for growth as new categories are launched and the brands are expanded into QVC's international markets.

Finally, our specialty retail channel continues to grow, and we are pleased with the progress we've made in the first quarter with new products introduced at Michaels and 1-800-Flowers.

So this concludes my overview of our first quarter business performance. Before I turn the call over to Jim, I want to reiterate our confidence in our ability to execute on our key initiatives across our three distribution platforms. Our business has never been stronger and our start to 2016 has us well-positioned to achieve another strong year of double digit top line growth.

Now, I'd like to turn the call over to Jim to review our financial results for the quarter. Jim?

James Haran:

Thanks, Bob. Please bear with me. It's allergy season so I'm going to try to (inaudible) my way through this.

I will briefly discuss selective financial results for the first quarter ended March 31, 2016. Please note that our financial results are described more fully in our Quarterly Report on Form 10-Q, which will be filed on or before May 16, 2016.

In the first quarter of 2016, revenues increased by 27% to $8.4 million, compared with $6.6 million in the prior year quarter. Increased revenues were primarily driven by licensing revenues generated by the H. Halston brands and the C.Wonder brand acquired in later December 2014 and in July 2015 respectively. Net loss for the quarter was $45,000 or $0.00 per share, compared with a net loss of $331,000 or minus $0.02 for the prior year quarter.

Non-GAAP net income for the quarter was $1.2 million or non-GAAP diluted EPS of $0.07 based on approximately 19.1 million weighted average shares outstanding compared with non-GAAP net income of $1.7 million or non-GAAP diluted EPS of $0.11 based on approximately 15.2 million weighted average shares outstanding for the prior year quarter.

Adjusted EBITDA in the first quarter of 2016 was approximately $2 million, representing a slight decrease of $200,000 from the prior year quarter's Adjusted EBITDA of $2.2 million. The decrease to our non-GAAP results was in line with our expectations and primarily due to investment spend associated with the development of a Quick Time Response production platform for the Hudson's Bay Company.

As a reminder, non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA are non-GAAP unaudited terms. Our Quarterly Report on Form 10-Q presents a reconciliation of these items with the most directly comparable GAAP measures.

Turning to our cash position. As of March 31, 2016, the Company had total cash and cash equivalents of approximately $12.6 million compared with total cash of $16.9 million at December 31, 2015. The $4.3 million decrease in cash was primarily attributable to $2.1 million in scheduled principal payments on our debt, and the $1.3 million of cash used in continuing operations.

The $1.3 million of cash used in continuing operations includes a $3 million decrease in cash from net changes in operating assets and liabilities, which consist of $2.1 million change in receivables and deferred revenue triggered by our revenue growth, and a $900,000 decrease in our current payables.

Also contributing to the decrease in cash during the quarter was $300,000 for common stock repurchases related to vested restricted stock in exchange for withholding taxes, $200,000 of capital expenditures associated with the build-out of our new office facility, and $300,000 paid as final satisfaction of the earn-outs associated with the Isaac Mizrahi acquisition.

Looking at our debt, at March 31, 2016, total liabilities were $48.3 million, which includes approximately $38.7 million of debt and $6.7 million of net deferred tax liability. Debt consists of our recently refinanced and consolidated bank term debt of $27.3 million and $11.4 million (inaudible) and contingent obligations, which are payable in stock or cash at the Company's option.

As of March 31, 2016, total current liabilities amounted to $10.2 million, of which $4.2 million represents the current portions of debt obligations payable in stock or cash at the Company's option.

Our working capital, excluding the $4.2 million obligation payable in stock, was $16.5 million compared with $16.1 million at December 31, 2015.

With approximately $13 million of cash and approximately $27 million of senior term debt, we continue to be positioned with one of the lowest leverage ratios of any of our industry peers.

With that, I would like to turn the call back over to Bob for his closing remarks. Bob?

Robert D'Loren:

Thank you, Jim. Your decongestant seemed to be working. Our positive first quarter results reflect the successful execution of our key initiatives to drive continued growth across our multi-plan portfolio and all distribution platforms. Although 2016 is both a transformative and in some respects transitional year, our continued investments in brands, people, and processes will position us strongly to achieve continued growth in 2016 and beyond. Frankly, we could not be more excited about the future prospects of our business.

In closing, as I have stated on past calls, our Company vision is to reimagine shopping, entertainment, and social as one. We have grown our business by building upon our ability to provide innovative solutions for today's retail industry challenges. Looking ahead, we are confident we will continue to improve top line growth across our brands, expanded profitability, and in turn, further increase long-term value for our shareholders.

That concludes our prepared remarks. Jim, Seth, and I will now open up the call for Q&A. Operator?

Operator:

Thank you. If you would like to ask a question, please press star, one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment.

We'll take a question from Eric Beder with Wunderlich Securities.

Eric Beder:

Good afternoon. Congratulations on a solid start to the year.

Robert D'Loren:

Thanks, Eric.

James Haran:

Thanks, Eric.

Eric Beder:

Let's talk a little bit about the new model you have for Hudson's Bay. You know, how transferrable is that from Hudson's Bay, and when you look at it, where do you want, you know, the wholesale business to go longer-term?

Robert D'Loren:

Eric, we built the platform for scalability, so the way we viewed the entire opportunity was to look at where we could help solve some of the challenges of many of the department store retailers that we're dealing with today, so we see it expanding beyond Hudson's Bay to retailers like Dillard's and possibly Bloomingdales, Nordstrom. There's no one that's really immune to the challenges that we're all facing in the industry today.

Eric Beder:

I mean how—when you look at this in terms of this Quick Response model and brands, how—what is the response you're receiving from people in the industry in terms of how they look at this as, you know, transformative or their ability to actively enroll this in quickly and fit it into their system?

Robert D'Loren:

I think the response across the board has been strong. Most retailers are interested in what we are doing. The goals of this program are to increase store traffic and drive more full price sell-throughs, so when you think of a solution that can provide both of those things, of course, there's going to be a lot of interest in it.

Eric Beder:

You're right now—let's talk a little bit about Highline. That's a brand that you created from whole cost. Do you plan on using that model in bringing more brands or is buying more brands the model, or is it a combination of both? Which one's easier for you to do? Which one do you even want to do?

Robert D'Loren:

I think it's a combination of both. Each way of approaching the business, of course, requires startup costs and time to develop. Acquisitions, of course, require capital; much more capital than creating a brand. But that said, you know, we tend to listen to our retail partners, look for white space opportunities within their stores and because we are moving so quickly with this QTR platform, if we can't buy a brand then if the retailer is receptive we can create a brand for them.

Seth Burroughs:

Yes, Eric, this is Seth. I would add to that, you know, there's—we still strongly believe in the value of brands as a mechanism to generate consumer trust and interest, and, you know, also, quite frankly engagement. When you have somebody (inaudible) was like an Isaac Mizrahi, he was 30 years experience, four time CFDA Award winner, so there's a lot of value to that brand so that when customers go to the store, you know, that's one factor in their decision to buy merchandise when they're at the department store. Another factor, obviously we strongly believe that the ability to cross-promote across our various platforms is a very attractive factor. That said, as Bob said, you know, some of the feedback from our department store partners is at the end of the day product trumps all, and if the product's not right, you know, then that's really the number one factor.

So, you know, in Highline Collective specifically, when we sat down with HBC and started planning what these brands and collections would look like, we saw an opportunity to create a brand that was really a trend-driven brand that we refer to as a big sister to some of the fast fashion brands that are out there; some of the more significant ones. So, you know, Highline Collective we're excited about it. It really is trend-driven. You know, it doesn't exactly fit into our model of having personalities behind, but that being said, as we continue to grow it, you know, and become successful, there's certainly opportunities to do so. But it doesn't, you know, it doesn't really have the intrinsic value of an Isaac Mizrahi so it's really a combination of both.

Robert D'Loren:

The one thing I would add to that, Eric, is while product has always been very important, we are now in a time where it's not entirely about product, product, product. Frankly, it is about process, process, process. That's what it takes to deliver a QTR platform, and that's what we have been working on for a good part of '15 and '16.

Eric Beder:

Okay. Then finally on QVC, you've had tremendous growth in QVC. When you look at it, is there still—are you talking about international, but is there still in the tested area white space with you to expand and continue to grow at QVC? It's been partnership but where can it go from here?

Robert D'Loren:

I think there are opportunities for us in new categories within our brands. For instance, with Isaac we've launched a denim collection. We've also launched a leisure collection. So, we see category opportunities with the brands that we have. We also are looking at additional white space opportunities for QVC where we would bring new brands to them, and I would expect that you will see something from us in '17 in the beauty space. We are working on developing skincare lines and also color cosmetic lines for them.

Eric Beder:

Great. Congratulations again. Thank you.

Robert D'Loren:

Okay. Thank you, Eric.

James Haran:

Thank you, Eric.

Operator:

No further questions. I would like to turn the call back over to Management for any additional or closing remarks.

Robert D'Loren:

Okay. Thank you, Operator. Ladies and gentlemen, thank you all for joining us here today. We remain hard at work growing our business and look forward to sharing our results for the second quarter in the coming months. We greatly appreciate your continued interest and support in Xcel. Finally, and as always, stay fit, eat well, and be healthy.

Operator:

This does conclude today's conference. We thank you for your participation. You may now disconnect.