Xcel Brands, Inc

Second Quarter 2016 Earnings Conference Call

August 9, 2016

CORPORATE PARTICIPANTS

Hunter Wells, *ICR Investor Relations*

Robert D'Loren, *Chairman and Chief Executive Officer*

James Haran, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Eric Beder, *Wunderlich Securities*

PRESENTATION

Operator:

Welcome to the Xcel Brands Second Quarter 2016 Earnings Conference Call. Please be advised that reproduction of this call in whole 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 evening, 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 second quarter ended June 30 2016, which went out today at approximately 4:05 p.m. Eastern time. In addition, the Company will file with the Securities and Exchange Commission its Quarterly Report on Form 10-Q for the quarter ended June 30, 2016, no later than August 15, 2016. The release and the Quarterly Report will 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 alternatives to net income, earnings per share, or any other measure of financial performance calculated and presented in accordance with 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:

Thank you, Hunter. Good evening, everyone, and thank you for joining us on today's call. I'll begin tonight with a high-level overview of our 2016 second quarter, and then will provide 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.

So let me start by saying that we are pleased with our overall results for both the quarter and six-months. I'm happy to report that we achieved double-digit revenue growth of 44% over the prior-year quarter and 36% on a six-month basis. As I stated earlier, Jim will discuss our financial results in more detail shortly.

We had a busy first half of 2016 in our brick-and-mortar Department Store business. In April, the IMNYC Isaac Mizrahi, H. Halston, and Highline Collective brands launched through our Quick Time Response, or QTR platform, in HBC's Lord & Taylor and The Bay Department stores in the US and Canada. We are happy with the current sell-through results of our QTR deliveries and are now working to optimize this platform. In fact, we are preparing to introduce this capability to additional potential retail partners and are optimistic that this would be a growth engine for us.

Given these difficult and, in many respects, transformative times the Retail industry is currently going through, we believe that some of our recent innovations in our business, particularly the offering of a fast virtual vertical production platform, or our QTR platform, are crucial to helping our current and future Retail partners drive customer traffic, increase full price sell-throughs, and enhance margins in these challenging times. As we continue to fine-tune and optimize our QTR platform, we intend to make additional investments in the platform with the goal of driving growth in our business. We remain excited and optimistic for the potential of this business. We believe that, ultimately, this business has the potential to generate maxes (phon) of $1 billion in Retail sale of our products over the next few years.

Moving from our Bricks-and-Mortar channel business to our Interactive Television business, our revenues from Interactive Television continued to grow. This is primarily due to growth in our core Apparel and Accessories businesses driven by acquisitions made in 2014 at 2015. We continue to see white space opportunities in these categories and are in the process of developing Beauty and Skincare brands for additional growth in this channel. QVC remains a key strategic partner for us and we continue to be excited by the significant opportunities for growth in this business.

Also, we continue to launch sales in our Interactive TV networks of our brands in QVC affiliates and other networks around the world. We currently broadcast in eight countries worldwide and expect continued growth in our Global Interactive Television business.

Finally, we continue to seek expansion of our Specialty Retail business. We believe there is significant opportunities for us in Home and Beauty, and expect to make announcements in these categories in 2017.

We are now more than halfway through 2016 and well on track to achieve another year of double-digit top line revenue growth while continuing to execute on our key strategic initiatives. That being said, we remain optimistic about the balance of 2016, but approach the second half of the year with caution given the current Retail environment. Finally, we believe that we are positioned very well for continued strong growth leading into 2017 and beyond.

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

James Haran:

Excuse me. Thanks, Bob. I will briefly discuss selected financial results for the second quarter and the six-months ended June 30, 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 August 15, 2016.

In the second quarter of 2016, revenues increased by 44% to $9.1 million compared with $6.3 million in the prior-year quarter. The increase in revenues was primarily due to the combination of higher revenues from Interactive Television, driven by acquisitions made in late 2014 and 2015, and revenues recognized from new license agreements entered into in 2015. These increases were partially offset by a decrease in revenues associated with the management and design of the LC&Y (phon) brand for which our contract subsequently ended on July 2016.

Net loss for the quarter was $90,000, or zero cents per share compared with net income of $2.1 million or $0.13 per share for the prior-year quarter. Non-GAAP net income for the current quarter was $2.1 million, or non-GAAP diluted EPS of $0.11 based on the approximately 19.4 million weighted average shares outstanding compared with non-GAAP net income of $1.1 million or non-GAAP diluted EPS of $0.07 based on approximately 16 million of weighted average shares outstanding for the prior-year quarter. Adjusted EBITDA in the second quarter of 2016 was approximately $2.7 million, representing an increase of approximately 44% from the prior-year quarter's Adjusted EBITDA of $1.9 million.

Moving to our six-month results, our revenues for the six-months ended June 30, 2016 increased by 36% to $17.5 million compared with $12.9 million in the same period in 2015. As with our quarterly results, the increased in 2016 six-month revenues was primarily due to higher revenues from Interactive Television, driven by acquisitions made late in 2014 and 2015, and revenues recognized for new license agreements entered into in 2015. These increases were partially offset by a decrease in revenues associated with the management and design of the LC&Y brand.

The current month net loss was $135,000, or minus $0.01 per share compared with net income of $1.8 million or $0.11 per share for the same period in the prior year. Non-GAAP net income for the six-months ended June 30, 2016 was $3.4 million or non-GAAP diluted EPS of $0.17 based on approximately 19.3 million weighted average shares outstanding compared with non-GAAP net income of $2.8 million or non-GAAP diluted EPS of $0.18 based on approximately 15.6 million weighted average shares outstanding for the same period in the prior year.

Adjusted EBITDA in the first six-months for 2016 was approximately $4.7 million compared with $4.1 million for the first six months of 2015. As a reminder, non-GAAP net income, non-GAAP diluted EPS, and Adjusted EBITDA are non-GAAP on all the (phon) 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 June 30, 2016, the Company had total cash and cash equivalents of approximately $13.5 million compared with total cash of $16.9 million at December 31, 2015. The $3.4 million decrease in cash was primarily attributable to $3 million in scheduled principal payments on our debt, and $1.7 million of capital expenditures for our new Corporate offices and operations facility. These cash outflows were partially offset by $2.3 million of cash generated from operating equities.

Also contributing to decrease of cash during the period was $400,000 of restricted cash related to the sublease of our former (phon) office, $300,000 for the share repurchases related to vested restricted stock in exchange for withholding taxes, and $300,000 paid as final satisfaction of the earn outs associated with the Isaac Mizrahi acquisition.

Looking at our debt, at June 30, 2016, total liabilities were $50.1 million, which includes approximately $37.9 million of debt and $6.5 million of net deferred tax liability that consists of our term debt of $26.5 million and $11.4 million selling notes (phon) and contingent obligations which are payable in stock or cash, the Company's option.

As of June 30, 2016, total current liabilities amounted to $11.9 million of which $4.3 million represents the current portions of debt obligations payable in stock or cash, at the Company's option. Our working capital, excluding the $4.3 million obligation payable in stock was $16.5 million compared with $16.1 million at December 31, 2015. With approximately $13.5 million of cash and approximately $26.5 million of senior term debt, we continue to be positioned with one of our lowest leverage ratios of any of our industry peers.

Before I turn the call back to Bob, I would like to conclude by saying that although we reported solid results for the quarter and six-months, given the challenges currently facing the Retail industry and the investments we are making this year to support our business have us more cautious for the remainder of 2016. That said, we believe that we are positioned well for future growth in 2017 and beyond.

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

Robert D'Loren:

Thank you, Jim. In summary, ladies and gentlemen, our second quarter results reflect the successful execution of our key initiatives to drive continued growth across our Multi-Brand, Multi-Channel portfolio. As I've said on previous calls, although 2016 is both a transformative and, in some respects, a transitional year for us, our continued investments in brands, people, and processes, coupled with a strong balance sheet, will position us strongly to achieve continued growth going forward. Frankly, we could not be more excited about our future prospects. We look forward to continued growth and increase long-term value for our Shareholders.

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

Operator:

Thank you. If you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star, one to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions.

Our first question comes from Eric Beder with Wunderlich Securities.

Eric Beder:

Good afternoon. Congratulations on a nice quarter.

Robert D'Loren:

Hi, Eric. Thank you.

James Haran:

Thank you, Eric.

Eric Beder:

So let's talk some things here. So, QVC—so obviously QVC came out with results last week and they talked about softness in July and going forward. Is that part of your thinking, being assertive (phon), and how is your business with QVC going?

Robert D'Loren:

I think, Eric, overall it's prudent to be cautious in this current Retail environmental, although QVC did report strong growth, particularly in their proprietary brands that relate to fashion. It's really hard to tell how the balance of the year really looks for both our businesses with QVC and, quite frankly, with our businesses in Department Stores, and in Specialty. So, we are just erring on the side of caution for Q3 and 4.

Eric Beder:

Okay. In addition, when you—how should we think about potential new relationships here and the potential to expand outlook beyond (inaudible)? What kind of—I guess, what are the learnings you're getting from the Hudson Bay experience to (phon) maximize it?

Robert D'Loren:

I think the most encouraging learnings that we're seeing with the Hudson's Bay project is the sell-throughs on our QTR, that is things where we are responding and getting back into some of the styles that are doing well for us, our sell-throughs have been very good and that's exactly what we expected in the program.

With that, we have begun the process of introducing other retailers virtually across every tier of Bricks-and-Mortar distribution to the whole program, and there is interest across the board and we hope that in '17 we'll be making announcements about expansion of the program.

Eric Beder:

Okay. How does M&A fit in here? How do you look upon that as a potential to how we're (phon) going forward; and what are you seeing in terms of valuations?

Robert D'Loren:

Well, M&A, the criteria has not changed. Of course, things need to be strategic. They need to fit in with the core competencies of the platform that we've built here at Xcel. They need to be synergistic with our existing brands and customer knowledge base, and then they need to be accretive. That said, with this new capability, it does open up a much broader base of acquisitions for us. We can look at companies that were perhaps more supply-chain-driven than just pure royalty-type businesses where we could now go in and convert them into our model. So, we continue to look for acquisition opportunities and see no reason why the pace that we've been going along at, say one acquisition per year, would change going forward.

James Haran:

Yes, Eric. One thing I would add to that is obviously it's a tough Retail environment for a lot of Retailers out there right now. The upside of that, when you look at our businesses both at a QVC, or we need to have a very strong business, and in Department stores where we believe we're bringing innovative solution to them, is there's an opportunity to leverage our platform that we've built, which is very leverage-able from an overhead standpoint, to really combine that with M&A and bring Retailers new brands, so bring QVC additional brands that would work well through QVC's platform, as well as through the Department Stores. So we do see an opportunity to leverage what we've built to date and grow it through M&A.

Robert D' Loren:

There's one other thing I would add to that, Eric. There is a bit of a new dynamic here at Xcel given some of the new capabilities that we've created, particularly with the QTR platform, and now some of the things that we're doing in Beauty. We're able to create brand, like Highline for Lord & Taylor and Hudson Bay, and we're doing similar things in Beauty with Skincare and Color Cosmetics. So the invested dollars up front are much lower, but, quite frankly, the potential could be the same. So, we're weighing all that as we go forward.

Eric Beder:

Last question, you've just moved into new locations; how has that changed the dynamic for you and what does that give you that you didn't have before?

Robert D' Loren:

Well, it gives us a much better operating environment as we began to allow the HBC (phon) program, working conditions were very tight in our old space and this gives us the flexibility now to grow into additional Retail platforms as we roll out the program.

Eric Beder:

Great. Congratulations and good luck in the back half of the year.

Robert D' Loren:

Thank you.

James Haran:

Thanks, Eric.

Operator:

Thank you. That concludes today's question-and-answer session. At this time I'll turn the conference back to Bob D'Loren, CEO, for any closing or closing comments.

Robert D'Loren:

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

Operator:

Thank you. This does conclude today's presentation. We thank you for your participation.