

Invest

Parlux Fragrances, Inc.

(Ticker Symbol: PARL)

Greetings from LFS

Dear Clients and Friends:



Invest is a quarterly newsletter created and distributed by LFS. The purposes are to offer:

- An investment idea that will perform regardless of market conditions.
- Insight into an industry including trends, opportunity and challenges.

I welcome any questions, comments or suggestions.

Sincerely,

Douglas Ruth

Parlux Fragrances, Inc. (PARL) was founded in 1984. The company is engaged in the business of creating, designing, manufacturing, distributing and selling prestige fragrances and beauty-related products. The majority (92 percent) of the company's revenues is generated from products sold under its *Paris Hilton* and *Jessica Simpson* brands.



Summary:

Fragrances are marketed and distributed using licensing agreements. The license can be obtained by paying a fee and using a person's name or a branded label. In December 2009, the company's relationship with *GUESS?* ended.

PARL's stock underperformed for two years and the company decided to make changes. On January 26, 2010, Frederick Purches, one of the founders of the company and previous Chairman, assumed the position of Chairman and Chief Executive Officer.

Invest

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Now, under Mr. Purches’s leadership, PARL appears positioned to, once again, increase sales and profits with the introduction of products under contracts with Dana Owens (Queen Latifah) and clothing designer Marc Ecko.

Sales of Queen and Marc Ecko Brands in Fiscal Year 2010
(In \$Millions)

Brand	Quarter				Total
	06/30	09/30	12/31	03/31	
Queen ¹	\$0.2 ²	\$5.9	\$4.6	\$3.2	\$13.7
Marc Ecko ³	-	\$1.7 ²	2.5	\$2.8	\$7.0

1. Product line announced in late June 2009.
2. Initial shipments.
3. Product line introduced late September 2009.

The company achieved revenue growth and returned to being a profitable enterprise during the first quarter of fiscal 2011.

Quarter 1 Results For Fiscal Years 2010 and 2011
(In \$Millions)

Period Ending	FY 2010	FY 2011
	06/30/09	06/30/10
Net sales	\$23.6	\$24.1
Net income (loss)	(\$2.5)	\$0.2

The company expects to be profitable in fiscal 2011 and is optimistic that its new licensing agreements will gain traction as revenue continues to expand in 2012.

PARL Projections as of October 12, 2010
(In \$Millions)

Fiscal Year	2010 ¹	2011 ²	2012 ²
Revenue	\$148	\$125	\$150
Net profit (loss)	(\$14.8)	Profitable	Higher than 2011

1. Actual amounts.
2. Projected amounts.

Valuation:



LFS believes that PARL is conservatively worth \$4 per share. The potential for the stock to appreciate more than 80 percent over the next several years seems possible. We are recommending that investors

consider PARL stock for maximum capital appreciation at this time.

Net Current Asset Stock:

The security is a net current asset stock. This type of situation is highly desirable because an investor’s chance for a favorable outcome is high.



Net Current Assets per Share – \$4.37:

Calculating Net Current Assets per Share

$$\frac{\text{Current Assets} - \text{Total Liabilities}}{\text{Number of Shares Outstanding}} = \text{Net Current Assets per Share}$$

$$\frac{\$103.7^1 - \$14.2^1}{20.5^1} = \$4.37$$

1. In \$Millions and millions of shares.

Share price as of October 25, 2010 – \$2.49.

Total Book Value – \$4.89.

Valuation and the Prestige Fragrance Business:

The prestige fragrance business is part of the fashion industry. There are a handful of fashion companies creating clothing and fragrances that remain in demand year after year. Overall, it is fairly common for a company to do well for a period of time and then decline. Occasionally, the decline is rapid. The

table below shows that PARL has a history of trading at extreme valuations.

The following tables show the stock prices, book value and price-to-book value of PARL stock from 2002 through 2010.



Stock Prices

	2002	2003	2004	2005	2006	2007	2008	2009	2010
High	\$1.77	\$1.55	\$6.87	\$13.92	\$19.24	\$16.30	\$5.78	\$7.15	\$2.61
Low	\$0.74	\$0.72	\$1.10	\$2.28	\$7.43	\$4.43	\$2.64	\$0.59	\$0.77

Book Value

2002	2003	2004	2005	2006	2007	2008	2009	2010
\$2.40	\$2.90	\$3.40	\$4.01	\$5.23	\$6.02	\$5.62	\$5.44	\$4.87

Price-to-Book Value

Stock Price	2002	2003	2004	2005	2006	2007	2008	2009	2010
High	0.74X	0.53X	2.02X	3.47X	3.68X	2.71X	1.03X	1.31X	0.54X
Low	0.31X	0.25X	0.32X	0.57X	1.42X	0.74X	0.47X	0.11X	0.16X

Extreme Value:

The stock can trade at either a substantial premium to its book value or, conversely, it will change hands at a fraction of its tangible assets.

- **High value:** During Fiscal 2006, it traded at 3.68 times its book value.
- **Low value:** Conversely, in Fiscal 2009, it traded at only 11 percent of book value.
- **Current value:** Currently, PARL is trading at about one-half its book value.

Calculation

<u>Stock price 10/25/10</u>	<u>\$2.49</u>	X 100 = 51% price-to-book
<u>Book value 06/30/10</u>	<u>\$4.89</u>	

LFS believes that PARL could trade at about 80 percent of its book value:

Book value 06/30/10	\$4.89
80% - 85% of book value	\$4.00

We believe that PARL is conservatively worth \$4.00 per share. The potential for the stock to appreciate more than 80 percent over the next several years seems possible.

Overview:

Parlux Fragrances, Inc. (PARL) was founded in 1984. The company is engaged in the business of creating, designing, manufacturing, distributing and selling prestige fragrances and beauty-related products. Products are marketed on a world-

wide basis primarily through:

- Specialty stores.
- National department stores.
- Perfumeries.

The fragrance market is generally divided into two segments:

- Prestige segment (distributed primarily through department and specialty stores).
- Mass market segment (distributed primarily through chain drug stores, mass merchandisers, smaller perfumeries and pharmacies).

PARL's fragrance products are positioned primarily in the prestige segment.



The company's principal products are fragrances, which are distributed in a variety of sizes and packaging. In addition, beauty-related products such as body lotions, creams, shower gels, deodorants, soaps, and dusting powders complement the fragrance line. The following table shows the general retail price of basic fragrance products.



Cost per Item

2006	2007	2008	2009	2010
\$20 - \$65	\$20 - \$65	\$20 - \$65	\$29 - \$65	\$29 - \$110

Licenses:

PARL creates and markets products through licensing arrangements. Securing a license and then creating a fragrance that customers enjoy purchasing is the biggest challenge and the greatest opportunity.

Designing and Creating Fragrances:

PARL's staff and independent contractors design and create fragrances. The actual manufacturing process is outsourced. The company's products are filled and packaged near its distribution center in Keasbey, New Jersey.

The company supervises packaging design by independent contractors to create products appealing to the intended customer base. This development process usually takes 12 to 18 months to complete.

The magic of the fragrance industry is to somehow mix a unique smell, container and brand that resonate with the buyer.



The licenses can be obtained via paying a fee and using either a:

- Person's name; or
- Branded product line.

Licensing Negotiations:

- Negotiating a licensing contract requires special skills. The licensee can be compensated using various methods, including:
 - Royalties (cash).
 - Stock options or warrants.
- Licenses generally have a limited life. They can often be sold, traded, subcontracted or occasionally cancelled.
- From time to time, the company makes strategic decisions about each of its licensing contracts.
- Some licenses appeal to international customers while others are only attractive to U.S. consumers.

Neil Katz:

Neil Katz was PARL's Chairman and CEO for only a short time:

Feb. 2007: Appointed interim CEO.

May 14, 2007: Appointed Chairman and CEO.

Jan. 20, 2010: "Resigned" because of philosophical differences regarding the company's future. During his tenure, he was instrumental in acquiring a number of new licenses.

Licenses Acquired by Neil Katz

Licensee	Effective Date
Jessica Simpson	June 1, 2007
Nicole Miller	August 1, 2007
Josie Natori	May 1, 2008
Queen Latifah	May 22, 2008
Marc Ecko	November 5, 2008
Rihanna	April 7, 2009
Kanye West	April 7, 2009

Artistic Brands: The licensing groundwork developed during Mr. Katz's tenure allowed PARL the opportunity to build a relationship with Artistic Brands, a company that represents singers Kanye West and Rihanna.

Status of PARL Licenses:

Licenses Providing Large Sales:

In fiscal 2010, PARL had three licensing agreements, each of which represented more than 10 percent of total sales.

Licenses as a Percentage of Sales¹

(In Percent of Total Sales)

Fiscal Year	2005	2006	2007	2008	2009	2010
GUESS? (license expired in December 2009)	N/A	20%	37%	23%	30%	28%
Paris Hilton (including accessories)	42%	69%	56%	68%	55%	42%
Jessica Simpson	N/A	N/A	N/A	N/A	13%	15%
Other	58%	11%	7%	9%	2%	15%
Total sales	100%	100%	100%	100%	100%	100%

1. Discrepancies in some numbers.

Licenses in Dollars¹

(In \$Millions)

Fiscal Year	2005	2006	2007	2008	2009	2010
GUESS? (license expired in December 2009)	\$0	\$21.3	\$49.7	\$35.4	\$45.4	\$41.5
Paris Hilton	10.5	73.4	75.2	104.5	83.2	62.2
Jessica Simpson	0	0	0	0	19.7	22.2
Other	14.6	11.7	9.5	13.8	2.9	22.2
Total sales	\$25.1	\$134.4	\$134.4	\$153.7	\$151.2	\$148.1

1. Discrepancies in some numbers.

Two Main Licenses:

Currently, the majority of PARL's revenue is generated from fragrance sales under licensing agreements with Paris Hilton and Jessica Simpson.



Paris Hilton¹: The Paris Hilton line of products is PARL's number one brand. She is:

- An American socialite, heiress, media personality, model, singer, author, fashion designer and actress.
- The great-granddaughter of Conrad Hilton (founder of the Hilton Hotels).
- Known for her appearance on the television series *The Simple Life* alongside fellow socialite and childhood friend Nicole Richie.
- During fiscal years 2009 and 2010, PARL introduced *Fairy Dust* and *Siren* under the Paris Hilton brand. Both products are selling well.

Ms. Hilton is scheduled to return to television in a new reality show soon. This could help the sales of her fragrances.

Jessica Simpson: Ms. Simpson is a singer, actress, television personality and fashion designer who rose to fame in 1999. She has:

- Seven *Billboard* Top 40 hits.
- A variety of commercials, three of which were high-profile for Pizza Hut.
- Parlux introduced a debut perfume in the Jessica Simpson line called *Fancy* in fiscal 2009. *Fancy* and the recently introduced *Fancy Love* generate more than \$20 million in annual revenue for PARL.



Gaining Traction:

The company has been pleased with the performance of its sales under the Queen Latifah and Marc Ecko licensing agreements.

Queen Latifah¹: She is an American rapper, actress and singer.

- Her work in music, film and television has earned her:
- A Golden Globe award.
- Two Screen Actors Guild Awards.

¹ From Wikipedia, the Free Encyclopedia.

- Two Image Awards.
- A Grammy award.
- Six Grammy nominations.
- An Emmy Award nomination.
- An Academy Award nomination.
- She has done commercials for a number of products.
- She has her own line of cosmetics for women of color called the *CoverGirl Queen Collection*.
- PARL offers a perfume called *Queen*, which was introduced in late June 2009.



Marc Ecko: Mr. Ecko is an entrepreneur and founder of a highly successful clothing line. According to the company's web site, Marc Ecko Enterprises includes:

- The *Cut and Sew Collection* in 2004. The collection:
 - Combines classic tailoring with bold graphics and subtle embellishments.
 - Was designed for those who want to start dressing a little more seriously but still maintain their youthful edge.

High hopes – Rihanna license: The company has high hopes for a new fragrance that will be introduced in the spring of 2011 under its new licensee, Rihanna. Rihanna is a Grammy award-winning singer and songwriter.

She has had seven number one singles since 2005. The company is optimistic that the Rihanna license will have international appeal.

Industry Trends:

The beauty industry, in general, is highly competitive and consumer preferences often change rapidly.

New Fragrances:

Because the public's interest in an individual celebrity can increase or decrease rapidly, a significant number of new prestige fragrance products continue to be introduced on a worldwide basis.

Seasonality of Sales:

Typical of the fragrance industry, the company's highest sales occur as customers purchase products before Mother's and Father's Day, and the calendar year-end holiday season, which fall during PARL's first and third fiscal quarters.

Retail Consolidation:

Over the last few years, the United States department store market has encountered a significant amount of consolidation. In recent years, Macy's has acquired Famous Barr, Federated Department Stores, Filene's, Foley's, Hecht's, Marshall Field's, May Corporation, and Robinson's.

Returning Merchandise:

An industry practice in the United States for businesses that market fragrances to department stores is to provide the department stores with rights to return merchandise. The company's fragrance products are subject to such return rights.

Large Inventory:

Inventories in the perfume industry tend to be large:

- The lead time of up to 180 days for certain raw materials and components requires the company to maintain at least a three- to six-month supply of some items in order to ensure production schedules.
- The lead times are most affected for glass and plastic components orders, as many of the designs are unique and require the production of molds in addition to the normal production process.
- When a new brand or Stock Keeping Unit (SKU) is launched, a six- to nine-month supply is frequently produced to ensure adequate inventories if sales of the new product exceed expectations.



PARL Partial Balance Sheet

	Fiscal Year	2005	2006	2007	2008	2009	2010
Inventory in \$Mil		\$32.7	\$69.4	\$56.2	\$48.1	\$66.7	\$41.8
Total current assets		\$73.8	\$153.9	\$114.1	\$122.3	\$128.7	\$103.4
Inventory as a % of current assets		44.3%	45.1%	49.3%	39.3%	51.8%	40.4%

PARL Inventory Days Outstanding

Period Ending Quarter	06/30 1	09/30 2	12/31 3	03/31 4
Fiscal Year ▼				
2006	228	240	319	326
2007	363	444	395	353
2008	432	337	260 ¹	227
2009	408	285	280 ²	345
2010	662	329	172	202
2011	419	TBA	TBA	TBA

1. Inconsistent: 02/07/08 – 274.
 2. Inconsistent: 02/10/09 – 280.
 TBA – To Be Announced.

- During the year ending March 31, 2009, PARL entered into agreements with two media companies to exchange inventory for future advertising credits on print, broadcasting, Internet and other media formats:
- The advertising credits are redeemable over three- and four-year periods, and were recorded based on the net cost of inventory exchanged.
- The following table shows the prepaid advertising credits for the year ending March 31, 2009:

Prepaid Advertising Credits for Fiscal 2008 (In \$Millions)

Current	\$0.6
Noncurrent	1.7
Total	\$2.3

Concentrated Customer Base:

PARL has a concentrated customer base. More than 40 percent of the company's sales are to two customers.

Customers Whose Sales Exceed 10 Percent (As a Percent of Total Sales)

Fiscal Year	2005	2006	2007	2008	2009	2010
Macy's				13%	22%	21%
Perfumania	24%	7%	9%	33%	27%	25%

Fragrance sale efforts in the United States are concentrated in a number of national and regional department store retailers. PARL also sells directly to perfumery and cosmetic retailers, including Perfumania, Sephora and Ulta retail stores. In the past, PARL also sold its products to GUESS? retail stores.

Perfumania:

Perfumania, Inc., is a specialty retailer of fragrances. The stores are located in manufacturers' outlet and regional malls. LFS believes that PARL's approximate 20-year relationship with Perfumania is unique and represents a competitive advantage for the following reasons. Perfumania:



- Is a high-volume customer.
- Does not return products to PARL.
- Does its own advertising.
- Has low distribution costs.

PARL allows Perfumania the opportunity to pay for purchases on longer payment terms. The relationship between the two companies has been dynamic and complicated at times.

Sales to Perfumania

Fiscal Year	2005	2006	2007	2008	2009	2010
Sales in \$Millions	\$6.0	\$7.5 ¹	\$11.7 ¹	\$51.2	\$41.5	\$37.6
As a % of total sales	24%	7%	9%	33%	27%	25%
Discontinued sales	\$29.4	\$15.9	\$5.5			
Number of retail outlets		240	260	315	360	370
Shares of stock owned as of						09/07/10 2,059,013

1. Excludes sales of \$15.6 million to Perry Ellis in 2006 and \$5.5 million in 2007.

Sales to Customers Who Exceed 10 Percent of Total Sales

(In \$Millions)

Fiscal Year	2005	2006	2007	2008	2009	2010
Perfumania	\$35.4	\$23.4 ¹	\$17.2 ¹	\$51.1	\$41.5	\$37.6
Macy's ²			-	20.6	34.6	33.8
Quality King				0	0	9.1
Total				\$71.7	\$76.1	\$80.5

1. Includes discontinued operations sales of \$ 15.9 in 2006 and \$5.5 million in 2007.

2. Before 2008, sales to Macy's were less than 10 percent of total sales.

Quality King Distributors:

The majority shareholders of Perfumania Holdings, Inc., are also the majority owners of Quality King Distributors, Inc. Quality King is a privately held wholesale distributor of pharmaceuticals and beauty care products. In 2010, sales to Quality King were \$9.1 million or 6 percent of total sales.

Other Customers:

Customer Summary

	2006	2007	2008	2009	2010
Belk	X	X	X	X	X
Bloomingdales					X
Bon Ton	X	X	X	X	X
Boscovs	X	X	X	X	X
Carson's	X	X	X	X	X
Dillard's				X	X
Famous Barr	X	X			
Filene's	X	X			
Foley's	X	X			
Hecht's	X	X			
Lord and Taylor's	X				
Macy's	X	X	X	X	X
Neiman Marcus					X
Marshall Field's	X	X			
Parisian	X				
J.C. Penney	X	X	X	X	X
Robinson's	X	X			
Saks					X
Sears				X	X
Stage Door	X	X	X	X	

International Sales:

International sales efforts are carried out through distributors in over 80 countries. The main focus has been in:

- Asia.
- Australia.
- Canada.
- The Caribbean.
- Europe.
- Latin America.
- The Middle East.
- East.Russia.

International Sales as a Percentage of Total Sales

2005	2006	2007	2008	2009	2010
20%	38%	37%	40%	37%	31%

International Gross Sales

(In \$Millions)

Fiscal Year	2005	2006	2007	2008	2009	2010
Latin America	\$17.3	\$43.3	\$29.9	\$27.2	\$19.1	\$11.4
Europe	4.2	8.4	9.7	15.9	15.6	16.4
Caribbean	2.2	1.4	1.2	6.3	2.1	1.6
Asia/Pacific	3.8	6.2	5.7	5.5	5.7	3.9
Canada	1.5	3.9	3.9	4.1	4.5	3.8
Middle East	1.0	10.0	12.1	1.7	4.8	5.0
Other	1.6	0.3	2.8	5.6	4.4	4.9
Total	\$31.60	\$73.5	\$65.3	\$66.3	\$56.2	\$47.0

Marketing and Sales:

In the United States, PARL:

- Has its own fragrance sales and marketing staff, and utilizes independent commissioned sales representatives for sales to domestic U.S. military bases and mail order distribution.
- Sells directly to retailers, primarily national and regional department stores, whom PARL believes will maintain the image of its products as prestige fragrances.
- Advertises directly through cooperative advertising programs in association with:
 - Major retailers.
 - In fashion media on a national basis.
 - Retailers’ statement enclosures and catalogs.
- Spends certain minimum amounts for advertising under the licensing agreements.



Number of Retail Outlets

2006	2007 - 2010
Over 2,000	Over 2,500

Extreme Values and Rules:

The nature of fashion companies is that they experience periods of both over- and under-performance.

- Understanding and accepting that the business can have extreme highs and lows is part of successfully managing a business like PARL.
- Managers of businesses that experience extreme operating fluctuations can develop a list of rules to help them.

Rule 1: Minimize debt.

Rule 2: If possible, maintain large cash balances and have access to a line of credit.

Rule 3: Provide incentives that reward employees for success. This is often done by granting stock options.

Rule 4: Work to develop new licensing agreements.

Rule 5: Understand and accept that many licensing agreements will not work out for various reasons.

Rule 6: Use the strength of the balance sheet when possible.

Rule 7: Be creative. The only rules and limitations are those inside your own mind.

Expense Control:

During the past five years, PARL has made some significant decisions that helped control expenses.

April 17, 2006 – Warehouse and Distribution Facility:

- Management and the Board of Directors determined that it would be more cost effective and prudent to relocate a major part of the company’s warehousing and distribution activities from Florida to the New Jersey area, close to where products are filled and packaged.
- Accordingly, on April 17, 2006, a five-year lease for 198,500 square feet of warehouse space in New Jersey was signed. This site also served as a backup information technology site for the Fort Lauderdale, Florida, facility.
- The company commenced activities in the New Jersey facility during the latter part of August 2006.

Fort Lauderdale, Florida, Corporate Headquarters:

With the relocation of the distribution center from Florida to New Jersey, PARL decided to downsize the corporate headquarters. On November 30, 2007, PARL entered into a lease agreement beginning during February 2008 for 19,072 square feet of office space in Fort Lauderdale, Florida. The Fort Lauderdale facility would serve as the company’s corporate headquarters.

- The organization continues to try to sublet its former 99,000-square-foot office/warehouse facility.
- A portion of the facility was sublet in Fiscal 2010.



I would like information on the following:

- Bassett Industries, Inc. (BSET)
- CCA Industries, Inc. (CAW)
- Chromcraft Revington, Inc. (CRC)
- Delphax Technologies, Inc. (DLPX)
- Deswell Industries Incorporated (DSWL)
- Lakeland Industries, Inc. (LAKE)
- Parlux Fragrances, Inc. (PARL)
- RELM Wireless Corp. (RWC)
- Reynolds America (RAI)
- West Marine (WMAR)

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