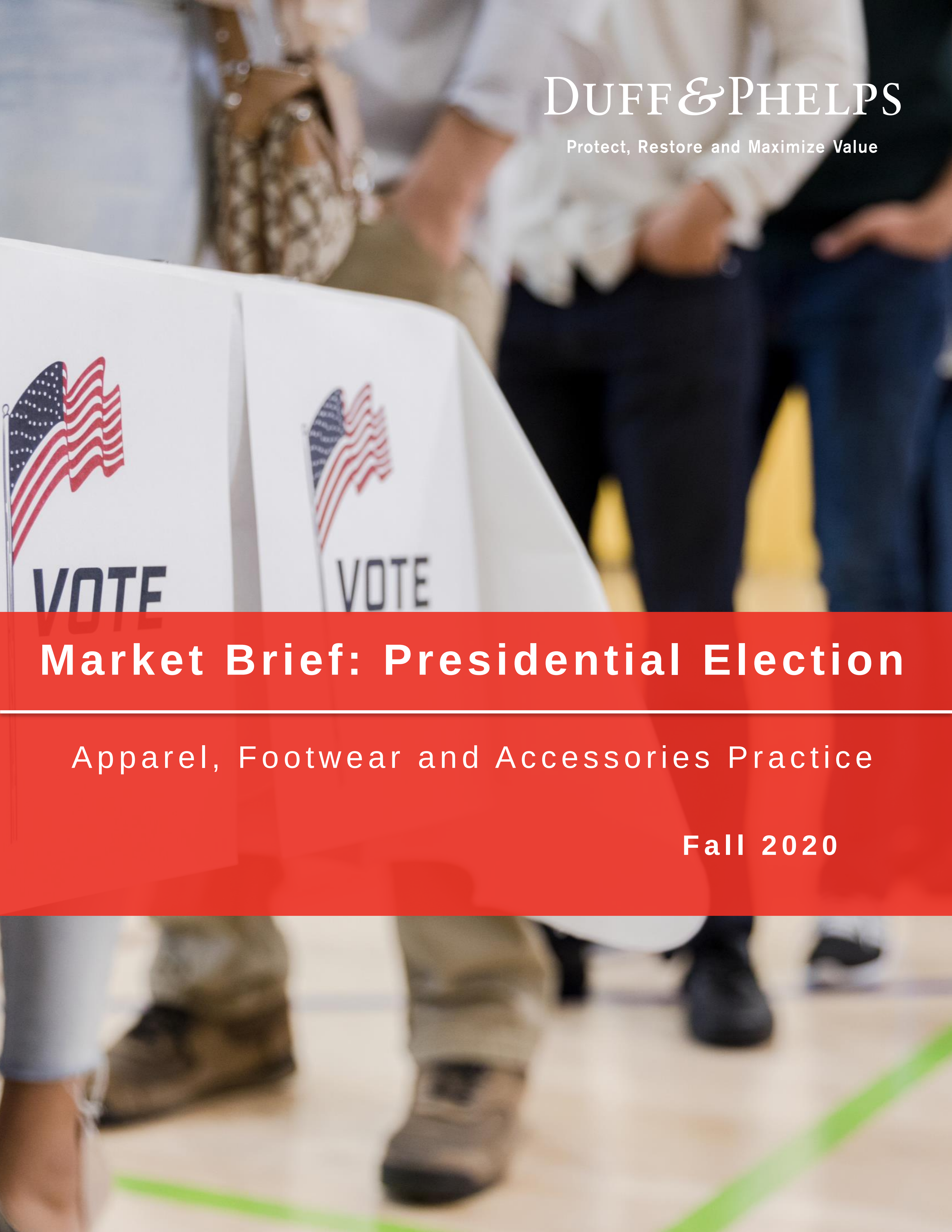


DUFF & PHELPS

Protect, Restore and Maximize Value

Market Brief: Presidential Election

Apparel, Footwear and Accessories Practice

Fall 2020

Apparel and Retail Amidst the Presidential Election

Fall 2020

While the COVID-19 pandemic shook up the retail and apparel sectors in the first half of year, the industry is showing signs of recovery consistent with the broader economy. As we move closer to the election, equity markets and key economic performance indicators continue to strengthen as the economy reopens and uncertainty regarding future performance declines.

We created this market brief to provide insight into how the upcoming U.S. election could potentially affect the apparel and retail sector. It is important to note that the actual impact may be influenced by various factors, including geopolitical and economic events. Nevertheless, we looked to prior elections to identify historical patterns with retail activity pre- and post-election and how M&A activity has fared throughout the period. We also summarize current candidate positions across tax and trade, which will invariably have a direct impact to apparel and retail, and spotlight how brands and retailers have become increasingly focused on sociopolitical alignment.

MARKET BRIEF CONTENTS | Key Summary Highlights

Heading into Election Week

- Retail sales may decline. Historically, the weeks leading up to the election result in a dramatic decrease in consumer confidence and spending.
- Consumer attention subject to drift. Around election time, the saturation of political advertising may impact the effectiveness of non-political marketing campaigns.

Following the Election Week

- Sales likely to bounce back. In 2016, sales volume two weeks following the election rose compared to election week, which in part may be a result of promotions leading up to Black Friday and Cyber Monday.
- Consumer spending may vary across states. Brands and retail stores may experience sales decreases greater in certain states that are aligned with the losing party's political party.

Candidate Policy Implications

- Tax Policy: A proposed full reversal of corporate tax cuts, combined with other potential increases to corporate taxes, could decrease corporate earnings in 2021 depending on the election result.
- Trade Policy: A combination of policy action and reaction with both Presidential candidates looking to be “tougher on China” could result in significant uncertainty for U.S. supply chains that are reliant on China.

M&A and Apparel Insights

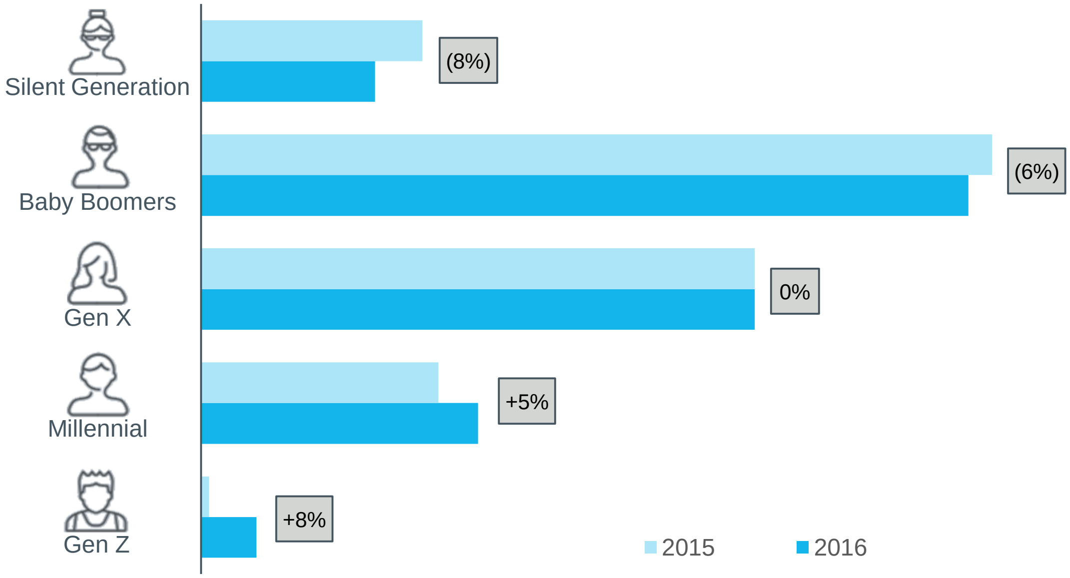
- M&A Activity During Election Year: Historically, companies considering a liquidity event around elections have generally sought to get deals done prior to any proposed increases in capital gains and corporate tax rates.
- Brands and Values: In this year's election cycle, brands have become more active in the political space, voicing their opinions and endorsing certain candidates and/or policies.

Themes Heading Into Election Week

1 Impact on Retail in Weeks Leading Up to the Election

Historically, the weeks leading up to the election have resulted in a dramatic decrease in consumer confidence and spending. As many are more concerned with the election outcome than shopping, the election week and two weeks prior are turbulent for retailers. In 2016, e-commerce retailer traffic fell 4.6% on election day and 10% the following day.[1] The last election's results are parallel to the 2008 election, when mall traffic and national retail traffic fell 12.4% during election week.[2] The drop in consumer confidence is not attributable to one party potentially losing the election. Rather, spending tends to decrease across political parties regardless of affiliation.[3] With controversy surrounding the upcoming 2020 election, coupled with ongoing COVID-19 in-store restrictions, the retail industry may experience declines in foot traffic and spending during the weeks prior to the election.

Gross Sales Trends During the Previous Election (2015 vs. 2016)[3]



Brands and retailers should (i) assess their core/target customer base and consider utilizing targeted marketing strategies to help circumvent potential spending declines across generations and (ii) modify current marketing strategies to account for the additional attention directed to the election and a distracted consumer.

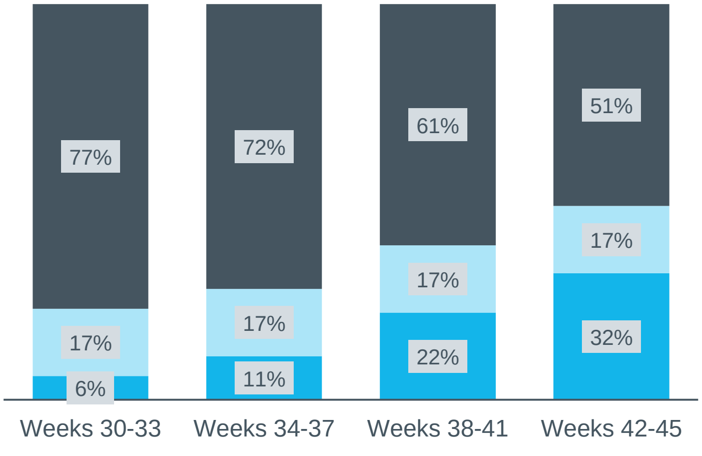
2 Politics Draw Marketing Attention Near Election

The abundance of political marketing has drawn attention away from non-political marketing campaigns. In 2016, during the last three weeks of the campaign season, political advertising accounted for 32% of local television ad time, an increase of 26% from the prior three-week period.[4]

Retailers generally have been aware of the magnitude of political advertising and the importance of navigating around this issue during election season. Retail stores are expected to be better prepared this year as they look to offer holiday shopping discounts closer to Black Friday rather than before or immediately after election day.[5] This will likely draw larger crowds of shoppers looking to fulfill their holiday shopping after the height of the election period subsides and political advertising takes less attention away from consumers.

2016 TV Share of Ad Time by Category[4]

Brands can employ a strategy of holding on marketing spend until after the election



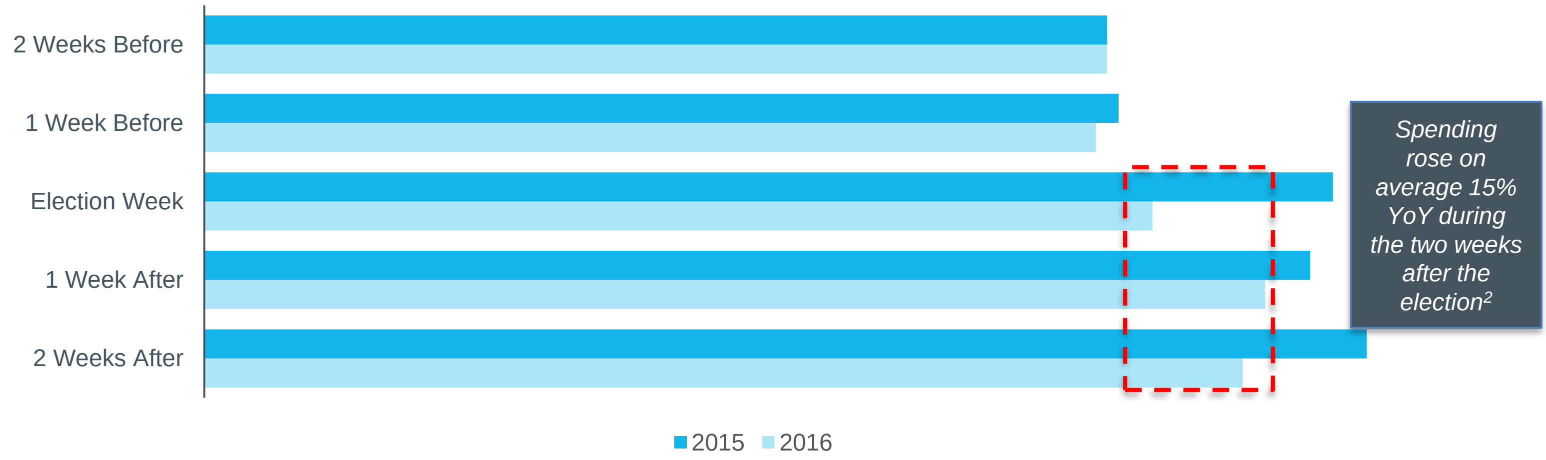
Sources: 1. Adobe Analytics 2. ShopperTrak 3. Epsilon 4. Kantar 5. Skirboll

1 Sales Bounce Back Quickly From Pre-Election Lag

While sales and foot traffic in retail stores are usually suppressed during the period leading up to an election, sales have historically rebounded to higher levels shortly after the election. Consumer spending tends to increase after the election as some are excited about the outcome while others seek to take the loss off their minds or simply out of relief that the election is over.[1] In 2016, sales levels two weeks following the election rose compared to election week.[2] The 2016 election experienced a larger jump in sales during the period after the election as compared to both the prior year in 2015 and the following year in 2017 (non-election years).[2] This was in part attributable to retail and brand promotions leading up to Black Friday and Cyber Monday, both of which are among the largest shopping days in the year. While many retailers expected the election to dampen holiday spending, Americans spent roughly $13 billion in a span of five days from Thanksgiving through Cyber Monday. This includes a 12% YoY increase on Thanksgiving, a 22% YoY increase on Black Friday and 12% increase YoY on Cyber Monday.[3] For retailers and brands, this trend of increased shopping will require adequate preparation to meet consumer demand.

2015 vs. 2016 % of Spend Around Election Week[2]

Consumers, regardless of sentiment, shop to make up for suppressed spending in prior weeks



2 Consumer Spending and Confidence Varies Across States Post-Election

Historically, post-election spending in a particular state has been correlated to which political party wins and that state's general political affiliation. Low levels and decreasing trends in consumer confidence tend to be associated with the incumbent's party losing the election. In the 2016 election, select states, all which allocated their electoral college votes to the candidate that lost the election, saw a greater decrease in sales as compared to other states.[3] Depending on the results of the upcoming election, brands and retailers may experience varying levels of sales performance across states.

2016 Democratic States Which Saw a Significant Sales Decline[3]

Sources: 1. NPD Group 2. Epsilon 3. Adobe Digital Insights 4. RBC Capital Markets

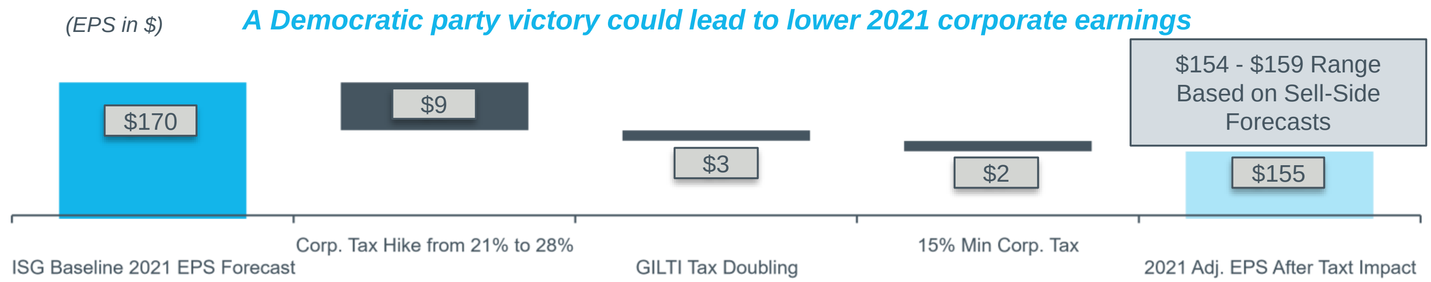
Candidate Policy Implications

1 Tax Implications

Both President Trump and Democratic Presidential candidate Joe Biden have proposed monumental changes to tax policies, but in opposite directions. President Trump has proposed to further lower taxes (i.e., individual tax and capital gains tax rates), whereas Biden has proposed to increase both measures. The table below highlights some of the candidate's tax policy positions[1,2] :

	President Trump	Biden
Individual Tax Rate	• Keep the top tax rate at 37% and implement a 10% rate cut for middle-income taxpayers, effectively lowering the 22% rate to 15%	• Raise the top tax rate from 37% to 39.6% for individuals with income above $400,000 and raise top effective rate for qualifying pass-through business income from 29.6% to 39.6%
Capital Gains and Dividends	• Retain the 20% rate on long-term capital gains	• Tax breaks would be eliminated for capital gains and dividends above $1 million and long-term capital gains taxed as ordinary income at 39.6% for taxpayers with an income over $1 million
Corporate Tax Rate	• Preserve the status quo, 21%, under the Tax Cuts and Jobs Act of 2017 and has no plans to reinstate a corporate AMT	• Raise the flat rate from 21% to 28% and reinstate the corporate AMT on profits of more than $100 million
Payroll Taxes	• Issued an executive order that postpones Social Security tax for employees for September 1 through the end of 2020 and has said that this reprieve could turn into a permanent extension	• 12.4% Social Security payroll tax, split between employers and employees, on earned income above $400,000

Potential Tax Reform Impact on 2021 S&P 500 EPS (Median of Sell-Side Estimates)[3]



2 Trade Implications

A combination of policy action and reaction with both Presidential candidates looking to be “tougher on China” could result in significant uncertainty for U.S. supply chains that are reliant on China. For apparel companies that use China’s cheaper resources for manufacturing and production, the overall cost may increase as a result of tariffs imposed by either party.

President Trump Administration

The President Trump administration has listed six items on its agenda relating to trade policy: enacting fair-trade deals that protect American jobs; "Made in America" tax credits; and four items focused on repatriating manufacturing jobs from China. The policies are largely based on tax credits, deductions and federal contract policy. One of President Trump’s largest trade policy campaigns is to “bring back one million manufacturing jobs from China.” He continues to prefer bilateral trade deals focused on goods, reform multilateral institutions, hold a dominating stance on China and focus on the U.S. trade-in goods deficit.[4]

Biden Administration

The Biden administration is seeking to balance trade policy between Americans that are hoping to keep their jobs in the U.S., and in another direction by corporations and farmers that are looking for tariff cuts and a more friendly relationship with China. Biden’s administration has not articulated a specific trade policy on its agenda thus far. However, the administration has explained that there will be changes to the current plan. One spokesperson said, “there is no going back to business as usual on trade” and there will be effort to “integrate climate change into their approach to trade.” [4]

Sources: 1. CPA Practice Advisor 2. Grant Thornton 3. Goldman Sachs 4. S&P Global

Additional M&A and Apparel Insights

1 M&A Activity During the Election Year

Historically, in election years where potential increases in capital gains and corporate tax rates could be meaningful, companies and entrepreneurs alike have been inclined to pursue a sale or liquidity event prior to a formal policy change. In 1986, when Ronald Reagan enacted a plan to change the highest capital gains tax rate from 20% to 28% in the following year, the market saw an increase of stock and asset sales by 60%.[2] This is a similar situation that companies faced in the end of 2010 and 2012. Expiring Bush-era tax cuts drove a considerable increase in M&A activity as both buyers and sellers sought favorable tax rates.[1] Immediately prior to the change, sales and capital gains realizations rose 40%.[3] These spikes in sales are representative of investors taking advantage of what has become a temporarily low tax rate. This year, companies may be willing to settle for a smaller sale value in the coming months, and still net more profit than selling at a higher value in the future, given the proposed tax increases by Biden.[2] While enacting new tax laws is no easy feat, the decrease in value from Biden's proposed tax increase may be incentivizing enough for companies to pursue a sale prior to the current tax policy potentially becoming obsolete.

The following example illustrates the potential federal tax difference between a company sale transaction that closes under current tax law vs. one that closes in 2021 or later under a potential Biden plan (assuming tax policy changes are retroactive to January 1, 2021).

Illustrative Potential Tax Impacts of a Company Sale Under the Biden Plan[4,6,7]

Assuming a company with $10 million of EBITDA is sold for a 10.0x multiple with $0 net debt, a transaction in 2020 under the current capital gains tax rate would result in after tax proceeds of $80 million vs. ~$60 million if a transaction were to occur under a Biden plan. To achieve a comparable level of after-tax proceeds, the company valuation multiple would need to be 3.2x higher.

($ in millions)

Timing of Sale	Illustrative Pre-Tax Proceeds	Tax Basis	Taxable Gain	Federal Tax Rate	Capital Gains Tax	Illustrative Post-Tax Proceeds	EBITDA Multiple
Pre-Biden Plan	$100	$0	$100	20.0%	$20	**$80**	10.0x
Post-Biden Plan	$100	$0	$100	39.6%	$40	**$60**	10.0x
Pre-Biden Plan	$100	$0	$100	20.0%	$20	$80	**10.0x**
Post-Biden Plan	$132	$0	$132	39.6%	$52	$80	**13.2x**

2 Brands are Becoming More Comfortable Extolling Their Values

Contrary to prior elections when politics and brand identity remained separate, this election cycle, brands have been much more active in the political space, voicing their opinions and endorsing the candidate they feel aligned with. As consumers develop a need for more authentic brands, publicly sharing such values may be in a retailer's best interest.

Brands understand the magnitude their voice carries with their audience and are acting in a more conscious manner. Fifty-six percent of retailers say they will be more aware of any political connotations that can be taken from their social media posts.[5] This election cycle, we expect to see brands integrate political views to their mission and endorse certain policies or candidates.

patagonia

Patagonia announced they plan to back the presidential candidate that has the strongest climate change policy. Patagonia has a section of its website dedicated to environmental activism.

WARBY PARKER

BIRCHBOX

Last year, CEOs from Warby Parker and Birchbox signed a letter to advocate for abortion access, indicating that without access it's a threat to health and independence.

In late 2018, Nike added Colin Kapernick, a former NFL player, to its list of sponsored athletes as a civil rights activist.

Sources: 1. CFO 2. CNBC 3. Tax Policy Center 4. Houlihan Lokey 5. Retail Touch Points
Notes: 6. Assumes that any legislation will be enacted swiftly if Biden is elected and all capital gains are long-term capital gains.
7. Does not include current state/city taxes, which can be as high as 13.3% depending on residency, and other potential federal taxes, such as the Net Investment Income Tax of 3.8%

About Our Practice

Duff & Phelps' Consumer group is among the most active middle-market advisors, providing sell-side, buy-side and capital raising services for clients worldwide. With expertise in the consumer, food, restaurant, apparel and retail sectors, our professionals have executed more than 150 transactions over the past 12 years.

The Duff & Phelps platform provides in-depth coverage of the apparel, footwear and accessories industry through dedicated, bicoastal consumer teams and 75 international offices. Duff & Phelps is a trade name for Duff & Phelps, LLC and its affiliates. Read more at www.duffandphelps.com.

#1 U.S. and global fairness opinion provider 2019[1]

#4 U.S. middle-market M&A advisor over the past ten years[2]

Proven Execution	100+ consumer M&A and capital raise transactions over the past 10 years
Deep Sector Expertise	Category focus drives thought leadership and builds invaluable relationships with buyers and investors alike
Customized Approach	Successful track record of premium value transactions driven by hands-on execution and creativity
Experienced Team	Over 30 bankers dedicated exclusively to the consumer sector within the U.S. alone
Global Platform	Nearly 4,000 employees across 70+ offices in 25 countries, with an extensive presence in the U.S., Europe and Asia

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1. Source: "Mergers & Acquisitions Review - Full Year 2019." Thomson Reuters.
2. Source: Thomson Financial Securities Data (U.S. deals \$15M < \$170M, including deals without a disclosed value). Full years 2010 through 2019.