SMARTER PERSPECTIVE: TARIFFS

U.S./Canada Tariff Developments: Implications for Industrial Businesses and Asset-Based Lenders

By John Sharpe

April 2025 The first quarter of 2025 has been marked by significant developments in the U.S.-Canada tariff landscape, creating a challenging environment for industrial businesses in Canada. The economic relationship between the two countries—long defined by stability, integration, and mutual reliance—has now been disrupted by new and escalating trade restrictions. These changes are introducing volatility into key decision-making areas for Canadian manufacturers, impacting investments, sales, costs, and overall business confidence.

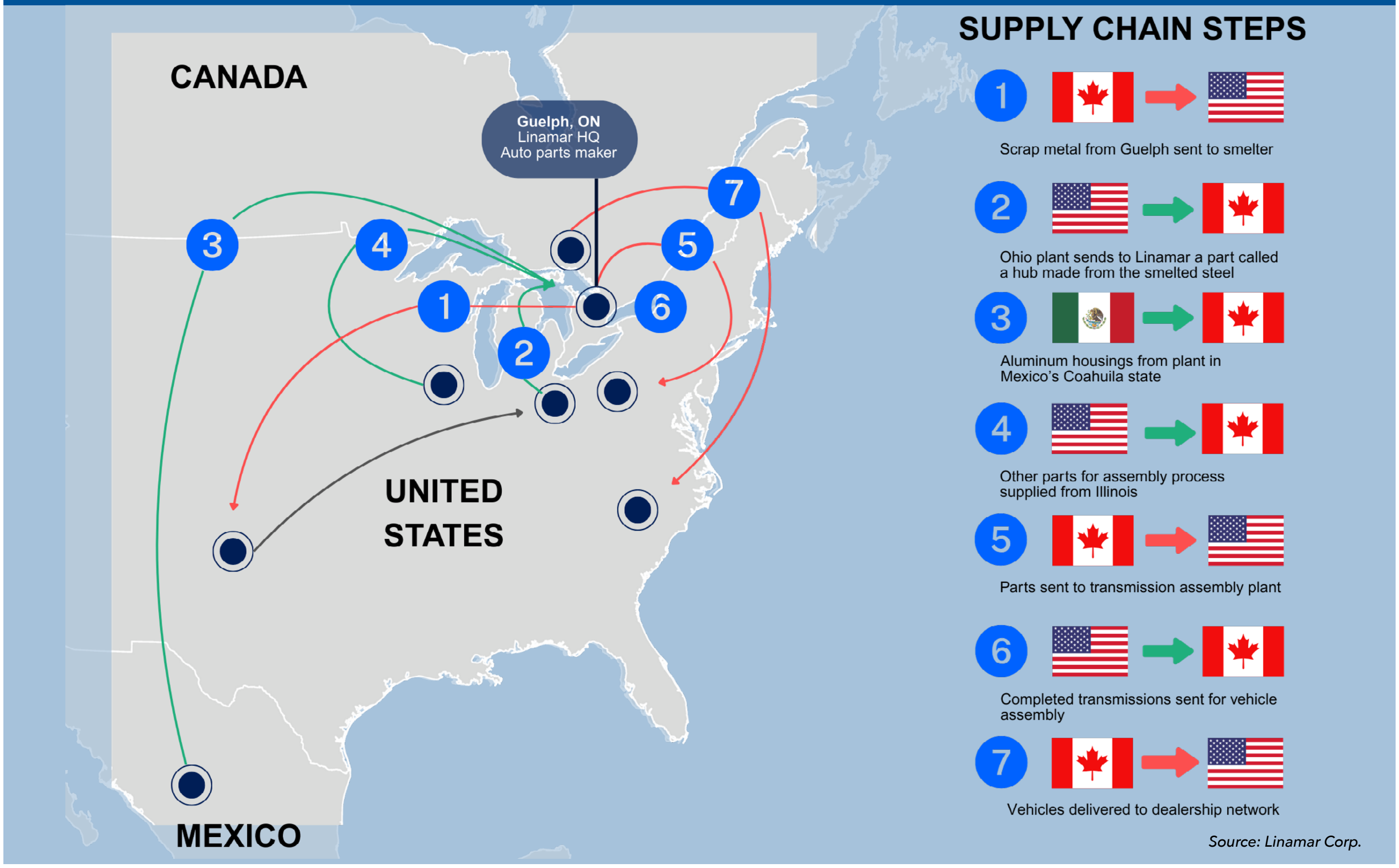
Investment Uncertainty and Declining Productivity

For industrial businesses in Canada, investment decisions often rely on a degree of predictability regarding future market conditions. However, the tariff environment in Q1 2025 has added a high degree of uncertainty, making it difficult for manufacturers to commit capital to new projects or expansion. The necessity of continuous investment in machinery, technology, and workforce development is at odds with the unpredictability of trade policies, and we are already seeing signs of this stalling planned implementation of productivity improvements. Any reluctance to invest will only exacerbate this problem and amplify lender risk, as underinvestment often leads to reduced business viability and declining asset values.

The Canadian government plays a crucial role in supporting manufacturers, but the level and type of assistance can vary significantly by province. Federal and provincial governments offer targeted subsidies, tax incentives, and grants to specific industries, often aligning with regional economic priorities—such as aerospace in Québec, automotive in Ontario, and energy-related manufacturing in Alberta. This uneven distribution of support can create competitive imbalances, giving certain provinces an advantage over their counterparts. Additionally, interprovincial trade barriers—such as regulatory differences and transportation restrictions—continue to hinder the free movement of goods, limiting manufacturing efficiency and national competitiveness. Reducing these internal barriers could strengthen domestic supply chains, improve productivity, and help to ensure that manufacturers across all provinces can compete on a level playing field. Lenders should be aware of this dynamic.

North American Auto Supply Chain

A transmission module, through seven steps, starts life in Ontario as Scrap metal and goes back and forth across the border seven times. This is a summary of that journey.



The Challenge of Selling into the U.S. Market

For decades, Canadian manufacturers have benefited from an integrated supply chain with the United States, often operating as though they were serving a domestic rather than an international market. The latest tariff policies, however, have highlighted the inherent "foreignness" of Canadian exporters to American customers. This shift in perception is already affecting sales, as U.S. buyers are being compelled by tariff actions to reevaluate their suppliers and look for alternatives that are unaffected by these newest trade barriers. Canadian business owners who previously took their U.S. market access for granted now must rethink their strategies, adding further strain to financial stability and growth prospects.

Rising Costs and Inflationary Pressures

The tariffs are driving up costs for Canadian manufacturers in multiple ways. Raw materials and components imported from the U.S. now come at a premium, making it harder for businesses to maintain competitive pricing. At the same time, the Canadian government has responded with counter-tariffs on U.S. goods, further increasing input costs. Compounding these issues, the weakening of the Canadian dollar relative to the U.S. dollar is making all imported goods more expensive. Many critical industrial inputs, including oil and steel, are priced in U.S. dollars, leading to cost escalations across a wide range of sectors. As a result, inflationary pressures are mounting in Canada, and manufacturers are already facing diminishing margins.

Interest Rate Dilemmas and Supply Chain Misalignment

The current economic environment presents a difficult challenge for policymakers. On the one hand, rising inflation and a depreciating currency suggest a need for higher interest rates to stabilize the economy. On the other hand, the slowdown in business investment and declining industrial activity argue for lower rates to spur growth. For now, the U.S. benchmark rate seems to be staying put, but the Canadian rate was cut by 25 basis points in mid-March. This lack of a clear direction further complicates financial planning for industrial businesses and the lenders who support them.

Moreover, the mismatch in time horizons between the rapid introduction of tariffs and the slow process of realigning

supply chains is creating additional financial strain. While tariffs can be imposed overnight, finding new suppliers, developing alternative trade relationships, and shifting manufacturing processes can take years. Businesses that are slow to adapt risk falling behind, while those that make hasty, non-strategic moves could face the burden of additional costs and inefficiencies.

Business Brokerage Market and Denial Among Some Manufacturers

The uncertainty surrounding tariffs has severely affected the business brokerage market. Industrial businesses with significant exposure to the U.S. are in crisis mode, unwilling to entertain acquisition discussions due to the perception that they will not receive fair value in the current climate. This hesitation is leading to stagnation in M&A activity and reducing liquidity options for business owners looking to exit.

At the same time, some Canadian manufacturers—particularly those in food production—seem to be in a bit of denial about their customers' ability to absorb increased costs. Unlike the manner in which those customers were willing to adapt to price inflation during the COVID-19 pandemic, American customers have learned from experience, now realize they have more optionality, and are already actively making moves to shift to suppliers who can provide them with more cost-effective solutions.

How Lenders Should Respond

Given these developments, asset-based lenders should take a proactive approach to monitoring and engaging with their industrial clients. Senior management at some lending institutions have already begun "scrubbing" their portfolios to assess which clients are most exposed to tariff-related risks and evaluating their contingency plans. To navigate this environment effectively, lenders should consider the following strategies:

1. Regular Portfolio Risk Assessments – Conduct detailed risk assessments to identify borrowers with the highest exposure to U.S. tariffs. Determine whether they have contingency plans, such as supply chain diversification or alternative markets.
2. Encourage Proactive Adjustments – Advise borrowers on diversifying their customer base and exploring non-U.S. markets. Manufacturers that take preemptive steps will be better positioned for long-term sustainability.
3. Monitor Financial Health Closely – Increased costs, declining sales, and inflationary pressures all threaten financial stability. Lenders should require more frequent financial reporting and stress testing to ensure clients remain viable.
4. Adapt Lending Structures – Given the current uncertainty, offering flexible loan structures—such as revolving credit facilities tied to asset performance—could help mitigate risks while providing borrowers with necessary liquidity.
5. Engage in Industry Advocacy – Lenders can play a role in industry discussions to encourage policy adjustments that minimize economic damage from tariffs. Collaborating with trade organizations and policymakers may help shape more favorable outcomes for Canadian manufacturers.

Concluding Thoughts

Canada's industrial sector is at a critical juncture, facing headwinds from increased tariffs, higher costs, and economic uncertainty. The reliance on a stable and open trade relationship with the U.S. has been a cornerstone of industrial success, but recent developments have disrupted this foundation. Manufacturers must adapt swiftly, and lenders must take a hands-on approach to protect their portfolios. By closely monitoring their borrowers, advocating for strategic adjustments, and adapting lending practices, asset based lenders can play a key role in navigating this challenging period. Moving forward, vigilance, adaptability, and proactive engagement will be essential for both sustaining industrial businesses and maintaining a stable lending environment. We are currently working with a range of industrial companies in the Canadian market and encourage you to reach out to our team to discuss any developing issues of concern that you may have with businesses in your portfolio. We are here to help.

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HCI invests capital alone and with other Hilco Global operating companies in multiple asset classes which includes: Real Estate, Accounts Receivables, Machinery & Equipment, Raw, WIP and Finished Inventory, Intellectual Property and many more. The ability to determine highly accurate valuations for unique assets, our knowledge of the channels best suited to their monetization, a thorough understanding of the business operations and companies that utilize those types of assets, and our reputation for certainty of close all combine to create unmatched optionality and maximize outcomes for our clients.

JOHN SHARPE IS AN EXECUTIVE VICE PRESIDENT AT HILCO COMMERCIAL INDUSTRIAL

John has over 30 years of experience in the industrial auction marketplace, having negotiated the acquisition and subsequent sale of hundreds of millions of dollars of industrial-related assets, including metalworking, plastics, printing, processing, construction equipment and so much more for such clients as General Electric, GM, National Acme as well as many medium and smaller size tool and die shops. Contact John at jsharpe@hilcoglobal.com or 416.451.9910.

Based in Toronto, Canada, over the years, he developed a reputation as one of the industry's true experts with a unique understanding of the industrial machinery & equipment, liquidation, and restructuring and insolvency markets from the ground up.