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FSAT NEWS

FINANCIAL SERVICES ADVISORY TEAM SPRING/SUMMER 2025

Welcome to our 33rd issue of FSAT News, a newsletter published by DJB's Financial Services Advisory Team (FSAT) to better inform and help you manage your business's potential.

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The Impact of U.S. Tariffs and Reciprocal Tariffs on Canadian Business Valuations and Sale Transactions

Trade policies have a significant impact on business operations and financial performance. A 25% tariff imposed by the United States on all Canadian exports and reciprocal tariffs on U.S. imports would present serious challenges to Canadian businesses, affecting revenue streams, supply chains, profitability, and ultimately business valuations. Some broad factors to consider in valuations and potential Mergers and Acquisition (M&A) transactions are discussed in this article.

Specific Industry Effects

Manufacturing & Export-Driven Industries

Canada's economy is heavily reliant on trade, with the U.S. being its largest trading partner. Tariffs by the U.S. government would significantly increase costs for U.S. importers purchasing Canadian goods, making Canadian products less competitive in the American market. Further, if reciprocal Canadian tariffs are implemented, Canadian businesses will be squeezed, from not only top-line revenue, but further from the cost of inputs. Manufacturing industries, such as automotive, steel, and aluminum would face declining sales and reduced margins. Potential considerations include pivoting to other markets and over a longer time, plant closures. Lower revenues and profitability would directly and negatively impact business valuations in these sectors.

Agriculture & Food Processing

Canadian agricultural exports, including beef, dairy, and grain, are dependent on U.S. consumers. A tariff would drive up prices for U.S. buyers, potentially leading to decreased demand and surplus inventory in Canada. This could cause financial distress for Canadian farmers and food processors, lowering company

3 | Approaches to Value Marketing-Related and Technology-Based Intangibles
4 | Valuing Economic Loss – Uncertainty Due to Tariffs
5 | Quality of Earnings – Importance of Revenue
6 | FSAT Team

valuations due to revenue volatility and margin compression.

Valuation Implications

Discounted Cash Flow (DCF) Analysis

Given the potential decline in revenue and increase to Cost Of Goods Sold (COGS), businesses affected by tariffs would likely experience lower future projected cash flows. This would result in lower valuations under a DCF approach, as investors demand higher risk premiums for companies exposed to trade volatility. Additionally, the heightened uncertainty surrounding trade policies and future profitability would necessitate an increase in the discount rate, similar to what was experienced in the early days of the pandemic.

Market Multiples & Comparable Transactions

Companies in industries heavily reliant on U.S. exports may see lower Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) multiples due to diminished profitability and increased uncertainty. M&A activity could decline as investors adopt a more cautious stance, further suppressing valuations.

Goodwill & Intangible Asset Impairment

For companies with significant U.S. exposure, goodwill and intangible assets may be subject to impairment tests if earnings projections are revised downward. This could result in the write-down of assets and negatively impact balance sheet strength, further affecting business valuations.

Risk & Uncertainty

The unpredictability of tariff implementation being announced, delayed for 30 days, and then reinstated creates a volatile business environment. It appears implementation of tariffs are changing daily. This ongoing uncertainty increases the overall risk profile of affected companies, leading to higher discount rates in valuation assessments. Investors and valuators must account for this instability, as fluctuating trade policies impact revenue predictability and cost structures.

Mitigation Strategies & Long-Term Considerations

Diversification of Markets

Companies could explore alternative markets beyond the U.S., including Europe and Asia, to reduce dependency on American buyers. Establishing trade agreements with other nations could mitigate some of the risks associated with U.S. tariffs. Further, companies may want to focus efforts on the domestic market and look for new opportunities.

Operational Efficiencies & Cost Management

Businesses should focus on improving operational efficiencies, optimizing supply chains, and exploring domestic sourcing options to offset tariff-related cost increases. Optimizing supply chains, may require finding domestic sources for previously imported materials. Lean manufacturing and automation investments could help maintain profitability.

Uncertainty in M&A

In M&A transactions, one approach to bridge the valuation gap in such uncertain conditions is to utilize an earn-out structure, where a portion of the purchase price is contingent upon meeting specific revenue or earnings targets. This helps mitigate the risk for buyers while allowing sellers to capture the upside if financial performance remains strong despite tariff challenges.

A tariff on all Canadian exports into the U.S. and reciprocal tariffs on all U.S. imports would have widespread ramifications for Canadian businesses, with adverse effects on financial performance, growth prospects, and business valuations. Companies operating in export-driven industries would face the greatest challenges, and strategic adaptation would be essential to weather the economic impact. Parties contemplating M&A transactions and valuation professionals must consider these risks when assessing businesses with U.S. exposure, incorporating adjusted financial forecasts, increased discount rates, and sensitivity analyses to account for trade volatility.

If you have any questions or require assistance regarding the impact of U.S. tariffs and reciprocal tariffs on Canadian business valuations or sale transactions, please contact a member of our Financial Services Advisory Team (FSAT) team.

Article written by: Colin Cook, CPA, CA, CBV, CFF

Approaches to Value Marketing-Related and Technology-Based Intangibles

This is the fourth article in a series on intangible assets and the various valuation methodologies and considerations. Please see our Spring 2024 and Fall 2024 FSAT News releases for the prior articles in this series.

From the previous articles in the series, we recap that there are five categories of identifiable intangible assets:

- Marketing-related;
- Customer-related;
- Contract-based;
- Technology-based; and
- Artistic-related.

In the Fall 2024 release of FSAT News, we discussed that customer-related intangible assets are often valued using the Multi-Period Excess Earnings Method (MEEM).

Relief-From-Royalty Approach (RFR)

For marketing-related intangibles, such as brand names and trade names or technology-based intangibles, such as software and licenses, one approach to determine value can be the RFR approach.

While there are some technical details to consider in applying the RFR approach, in simple terms, this method determines the value of the intangible asset based on the hypothetical savings by owning the asset instead of licensing it from a third party. This savings is estimated by applying a market-based royalty rate to a forecast future revenue stream from use of the asset. This stream of royalty income is reduced for income taxes and discounted to a present value as at the valuation date.

The RFR approach is simpler to calculate than a MEEM but determining and selecting an appropriate royalty rate can be challenging if there are limited comparable products in the market. Additionally, research and professional judgment is required to determine the economic life of the intangible asset, as most brand names, trade names, and technologies have a finite lifespan.

Selecting a Comparable Royalty Rate

To select a comparable royalty rate, royalty agreements for similar intangible assets are often reviewed and evaluated based on the following factors:

- The date of the transaction. Royalty agreements near the transaction date may more accurately reflect comparable royalty rates.
- Any non-cash considerations. A more complex transaction involving multiple non-cash considerations typically leads to a higher royalty rate.
- The royalty rate should be determined by examining royalty agreements between third parties, rather than those between related parties to ensure they represent market rates.
- Whether the agreement is for global usage or limited to specific territories.
- Whether there are legal means to protect intellectual property in the territory where the royalty agreement applies. Lack of legal protection will decrease the royalty rate.
- Profitability of the intangible asset and whether there is ability to pay the royalty rate.
- The base on which the royalty rate is applied to the agreements, such as gross revenue, net revenue, gross profit, etc.

Alternative Approaches to RFR

In situations where royalty agreements or market royalty rates are not readily available for review, alternative approaches to value marketing-related and technology-based intangibles include, but is not limited to, reviewing the acquired company's existing agreements or calculating the return on investment of the intangible asset.

Selecting an appropriate royalty rate for the RFR approach or applying an alternative approach to RFR requires careful consideration. If you have any questions or require assistance regarding business combinations and valuing brand/trade names or technologies, please contact a member of our Financial Services Advisory Team (FSAT) team.

Article written by: Rachel Mak, CBV

Valuing Economic Loss – Uncertainty Due to Tariffs

Tariffs – Sorry, I know -- we have all heard enough about tariffs by now. But, unfortunately we need to consider the uncertainty that the new tariffs may have on our economic loss calculations.

At the time of writing, the threat and impact of the new U.S. tariffs has only just begun. A bit "on again, off again", with most being deferred for the short term. Additionally, Canada is threatening to add tariffs to goods imported from the U.S. No one knows how long this trade war will last, but the (almost) unanimous expectation is that the economies in both the U.S. and Canada will suffer. Costs will likely increase, supply chains may be disrupted , and U.S. markets for Canadian goods may be closed. We have already seen reports of U.S. orders for Canadian products being cancelled, or postponed, as there is anticipation that the cost to the U.S. purchaser could go up by the amount of the tariff (e.g., 25%).

So, how does all this affect our economic loss calculations? In short, when calculating the economic loss for an employed or self-employed individual, we need to consider what their income would have been, had they not been injured in an accident (i.e., a motor vehicle accident, slip and fall, etc.). Under normal, stable economic conditions, the potential earnings are often estimated based on what the person was earning at the time of the accident, or perhaps an inflation-adjusted average of their pre-accident earnings. However, due to the introduction of new and anticipated tariffs, this approach may not be practical in the short term.

We encountered similar uncertainty in 2020 at the start of the COVID-19 pandemic. At that time, we did not know how long the pandemic would last, or what the effects would be on any specific industry or occupation. In time, the effects became more clear, and we were able to incorporate this information in our calculations. We expect the same will be true with these new trade war tariffs.

Of course, every situation will have to be considered on its own. Some industries, or individuals may not be significantly affected by the tariffs, while others could be significantly impacted. We will need to consider how the new tariffs may affect the individual's potential earnings, had they not been injured.

For now, we may not be able to specifically estimate the potential impact of the tariffs, but it is important to address the issue. In time, we will learn more about the effects on various industries and occupations.

Ultimately, calculating the value of lost employment or self-employment income for economic loss purposes is a complicated issue, with each case presenting its own set of unique challenges. Our Financial Services Advisory Team (FSAT) has extensive experience preparing these calculations. If you have any questions or require assistance with a calculation, please contact a member of our team.

But for now – Buy Canadian.

Article written by: Brent Pyper, CPA, CA, CFF

FSAT Services

- Assistance with Business, Acquisitions & Divestitures, including Due Diligence & Quality of Earnings Reports
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- Business Valuation
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- Income Replacement Benefit (IRB) & Other Accident Benefit (AB) Calculations
- Long-Term Disability Calculations
- Matrimonial Disputes
- Shareholder Agreements & Dispute Resolution
- Value of Future Care Cost Analysis
- Wrongful Dismissal Claims

Quality of Earnings – Importance of Revenue

In the Fall 2024 issue of our FSAT newsletter, we introduced what Quality of Earnings (QoE) reports typically include and why they may be needed. In this article, we will continue discussing various aspects of QoE reports by exploring the importance of a quality of revenue analysis.

Understanding revenue quality is an important component in a quality of earnings analysis in mergers & acquisitions (M&A) transactions. Factors often considered when assessing the quality of revenue include the accuracy, sustainability, growth, profitability, and that the reported revenue has been collected. In M&A transactions, an in-depth quality of revenue analysis helps to identify potential risks and provides insight into the target company's ability to maintain and grow its revenue and earnings post-acquisition.

Assessing Revenue Accuracy

Testing revenue accuracy is an important step in a QoE analysis. One method that can be used to analyze the accuracy of a company's revenue is called a "cash proof of revenue" analysis. In a cash proof of revenue analysis, the company's reported revenue in its financial statements is reconciled to the cash deposits reported in its bank statements. By completing this process, a buyer can have confidence that the reported revenue matches third-party sources, such as bank statements. If the company reports significant accrual revenue during the period or there are significant accounts receivable that have not been collected, the makeup of the balances may also be analyzed for accuracy and collectability.

Evaluating Revenue Sustainability

The sustainability of a company's revenue is another important area to consider in a QoE analysis. Revenue is considered to be of high quality when it is generated by a company's core operations and is derived from recurring customers, rather than one-time transactions or temporary factors. In a QoE analysis, the company's historical revenue may be analyzed to assess its sources and to identify any non-recurring or extraordinary items. Examples of non-recurring items include one-time sales, legal settlements, or insurance proceeds. This analysis can also help identify risks associated with the company's various sources of revenue, such as dependance on key customers or significant contracts.

Analyzing Revenue Growth

Undertaking an analysis of a company's historical revenue growth can help assess whether the growth is sustainable and representative of the company's future performance. Examining the company's historical revenue may identify important trends or abnormalities that a buyer should consider during the due diligence process. It is important to identify the drivers of revenue growth, such as new products/services, new customers, or cyclical factors, to evaluate whether these growth patterns are likely to continue.

Understanding Profitability

Finally, a profitability analysis can be a valuable tool for evaluating the quality of a company's revenue and earnings. By examining various profitability ratios, such as gross profit margin, net profit margin, and return on assets, one can gain insight into the company's financial health. Additionally, an analysis of the profitability of the various revenue sources can help determine the sustainability of the company's revenue and earnings in the future.

In conclusion, a thorough analysis of revenue can be a key component of a QoE report. A QoE report helps identify potential risks and support decisions regarding a potential transaction.

At DJB, our team of specialists have the professional experience needed to assist prospective buyers and business owners, and their advisors and lenders throughout the transaction process. Our trusted professionals can assist with many aspects of M&A transactions, including the financial and tax due diligence, as well as preparing QoE reports.

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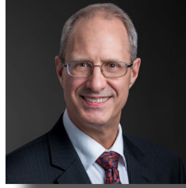

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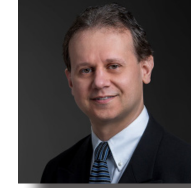

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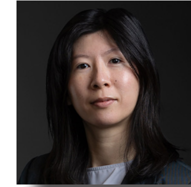

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