INVENTORY TRENDS

Back To The Future – The Advent Of Re-Shoring And Its Impact On Secured Financing

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Over the past three decades, we have witnessed a shift in manufacturing sourcing strategies, moving from domestic to global, to near-shoring, and now back to domestic sourcing.

Cost-Based Competition

Between the late-1980s and the 1990s, the go-to sourcing strategy focused on challenging U.S.-based suppliers to increase efficiency and lower their product prices. Lean manufacturing, just-in-time, and the Toyota way were common buzzwords.

Haunting memories of Ignacio Lopez and his cost-cutting pressures still linger in the more seasoned members of the automotive parts supplier community. The heart of this strategy was U.S. production and U.S. supplier versus U.S. supplier competition.

Off-Sourcing

As the calendar entered the 21st century, the focus shifted. The new buzzword became the 'China price". Manufacturers focused on reducing their per-unit costs. This unit cost comparison became the bellwether measure, and the sole focus on unit price encouraged manufacturers to relocate production from the USA to low-labor-cost markets, such as China, to achieve these lower unit price targets. This low-unit-cost sourcing strategy was the go-to strategy for the next 20 years.

However, as time progressed, it became increasingly evident that there was more to "cost" than just per unit price.

Other factors came to light, such as:

- Transportation costs
- Transportation availability and port logistics
- The level of investment in products throughout the entire supply chain (at the port of origin, on the ship, at the receiving port, on the truck, and at the warehouse)
- This extended supply chain required a change in philosophy from just-in-time to just-in-case inventory buffers.
- The heightened inventory investment brought implications of any product design change and related prior production product scrap.
- As more production was sourced abroad, the labor costs in the low-cost countries began to rise.
- Improved production, assembly, and material handling and robotic automation solutions reduced the advantages of low-cost labor markets.
- Continued evidence of the lack of intellectual property rights' protections in China
- Geo-political concerns regarding the stability of the political relations between countries and their related impact on business operations.

While these factors began to be incorporated in the sourcing calculus, production sourcing continued to have a global focus. Changes to the sourcing process were relatively minor and included enhancements such as relocating production from China to other low-cost Asian countries, including Vietnam, Indonesia, Thailand, and India.

Near-Shoring

The major shift in sourcing strategy came with the advent of the COVID-19 pandemic. Government restrictions regarding what products could and could not be exported from China became real. While the most visible sectors of impact were personal protection products (such as masks and gloves) and certain pharmaceuticals, the potential negative implications of this new practice impacting other sectors became more apparent.

An additional factor that impacted the sourcing process at the time was transportation disruptions and related inflation. Port congestion, labor shortages, container shortages, and freight rate volatility all contributed to the issue. For example, spot rates for 40 ft containers from China to the U.S. West Coast rose from \$2,000 to as high as \$20,000 in some cases.

As these factors were given greater weight in the sourcing equation, the focus shifted from off-shored production in Asia to moving production to a location closer to the end market, also known as near-shoring. Seeking the best of both low costs and closer proximity to the end consumer resulted in a new go-to location; Mexico was the logical choice.

Mexico offered several advantages, including a low cost of labor, a sizable pool of engineering and managerial-level personnel, and closer proximity to next-level production and the end consumer, as well as trade-related coverage under the

USMCA trade agreement.

Partially counter-balancing the advantages, the challenges to this near-shoring strategy included:

- uncertainty in the Mexican legal system,
- personal security concerns for expats and employees
- difficulty of financing Mexican-based inventory and equipment
- Increasing tensions between Mexico and the U.S. resulting from immigration and drug trafficking issues.

Re-shoring

The near-shoring strategy began to slow in November 2024 when the newly elected President Trump announced the planned imposition of 25% tariffs on all imports from Mexico not subject to USMCA exemptions.

During the following months, there were considerable challenges and swings due to suspensions to allow time for additional negotiations and delays due to legal challenges. This level of uncertainty regarding the Mexican-based production has had a chilling effect on plans for further investment in Mexico. We have recently heard that one auto OEM has specifically requested "All USA content" quotes for new programs.

These factors generated an interest in re-shoring previously outsourced production from U.S. firms. They have also encouraged the movement of non-U.S. firms to relocate production to the US to avoid tariffs.

A listing of significant investment commitments announced by U.S. and foreign corporations and foreign governments for sourcing within the U.S. is listed as an exhibit to this article.

Secured Financing Implications

- The trend of re-shoring production back to the U.S. will require significant capital investment in the USA.
- A sizable portion of this capital investment requirement will be borne by the middle-market and small businesses that are suppliers and service providers to the larger U.S. and foreign-owned corporate entities.
- These firms will require access to secured financing solutions to meet the related needs.
- Manufacturing and Warehouse Funding Needs

  - The re-shoring businesses and their suppliers will need to secure access to the expanded manufacturing and warehouse facilities required for their expanded U.S. production either through direct ownership or through lease structures with real estate investors.

  - The construction and long-term financing needs associated with this investment in facilities will need to be addressed through the combination of commercial banks, non-bank real estate lending sources, as well as SBA lending programs, credit unions, and community banks for

Exhibit

The following list includes significant investment commitments made for the U.S.-based production that have been officially announced.

U.S. Company Investments

- AbbVie - $10 billion pharmaceutical manufacturing
- Amazon - $34 billion in cloud computing and AI infrastructure
- Apple - $600 billion for AI server facilities and manufacturing
- Blackstone - $25 billion in digital and energy infrastructure
- Bristol Myers Squibb - $40 billion in manufacturing and R&D
- Clarios - $6 billioon in manufacturing for batteries and related products
- El iLilly - $50 billion expansion of US pharmaceutical manufacturing
- Ford - $20 billion in advanced manufacturing
- GE Appliance - $3 billion in plant expansion
- Gilead Sciences - $11 billion in manufacturing and R&D
- Google - $25 billion for AI training and data centers
- IBM - $150 billion for growth and manufacturing operations
- John Deere - $20 billion in manufacturing
- Johnson & Johnson - $57 billion in manufacturing and R&D
- Kraft Heinz - $3 billion upgrade and expansion of US production
- Mars - $2 billion in expanded manufacturing
- Merck- $9.9 billion in pharmaceutical manufacturing
- Micron - $200 billion for semiconductor manufacturing and R&D
- NVIDIA - $500 billion for AI infrastructure and supercomputers
- Pratt - $5 billion in manufacturing
- Stellantis - $5 billion in manufacturing
- Thermo Fisher Scientific - $2 billion in manufacturing
- Vantage Data Centers - $25 billion in data centers

Foreign Company Investments

- DAMAC Properties - $20 billion in data centers
- GlobalWafers - $4 billion in silicon wafer production
- GlobalFoundries - $16 billion chip manufacturing facilities
- Hikma Pharmaceuticals - $1 billion
- Hyundai Motor Group - $26 billion in steel, automotive, and robotics manufacturing
- Novartis - $23 billion in pharmaceutical manufacturing
- Roche / Genentech – $50 billion in pharmaceutical manufacturing and R&D
- Samsung - AstraZeneca - $50 billion in pharmaceutical manufacturing and R&D
- Sanofi - $20 billion in pharmaceutical manufacturing and R&D.
- SoftBank - $500 billion in AI infrastructure
- Taiwan Semiconductor Manufacturing Company - $100 billion chip manufacturing facility in Arizona.
- UCB - $5 billion in pharmaceutical manufacturing.

Foreign Government Investments

- EU - $600 billion investment across several sectors and commitment to purchase $750 billion in US energy over 3 years
- India - $500 billion in trade and manufacturing
- Japan - $1 trillion investment in US manufacturing, auto plants, and steel production.
- Qatar - $1.2 trillion in manufacturing and technology
- Saudi Arabia - $600 billion in manufacturing and energy
- South Korea – investment of $350 billion in projects and a commitment to purchase $100 billion from the US energy sector.
- United Arab Emirates - $1.4 trillion across technology, aerospace, and energy sectors

smaller facilities.

- Related Construction Contractor Needs

- The anticipated level of construction required to meet these facility requirements will also have indirect credit-related impacts on the construction contractor sector.

- The working capital needs of the construction contractor sector have been met with limited appetite by the commercial banking community. The sector is viewed as higher risk due to the industry's percentage of completion accounting, progress billings, and front-end loaded expenditures for materials and labor.

- These conditions have given rise to several independent lenders that have developed funding solutions specifically designed to address the needs and the risks associated with lending to this sector.

- The construction AR lenders have structured their lending facilities and their operations to work within the complexities of progress billing, milestone billing, and pay-when-paid environments.

- Other lenders have developed solutions to address the upfront funding needs related to material purchases and other mobilization expenditures.

- We would anticipate that these types of specialized contractor finance solutions will see robust growth in this re-shoring environment.

As a result of many influencing factors, we are entering into a phase of significant investment in manufacturing capacity within the U.S. This will involve U.S. companies re-shoring production that was previously outsourced to low-cost countries, as well as non-U.S. companies relocating production from foreign locations to the U.S. to avoid tariffs and other trade-related restrictions.

- Infrastructure Funding Needs

- There will also be the need for infrastructure investment and enhancements to support this higher level of commerce. This will include road and bridge investment, port expansion for exports, water and sewage systems, energy generation, and transmission infrastructure.

- While most of this investment will be funded through government entities and publicly traded energy corporations and utilities, the contractors constructing the various projects will have working capital financing needs (accounts receivable and materials) as well as increased investment in equipment.

- Production, Assembly, Quality Control, and Material Processing Equipment and Related Tooling Funding Needs

- There will need to be considerable investment in new equipment to produce, assemble, and move the products through the production and distribution process.

- This will create a significant incremental demand for equipment-based loans and lease financing.

- Some of this equipment will be non-custom equipment, such as CNC milling and machines and lathes, injection molding machines, stamping presses, heat treating, EDM and laser cutting, coordinate measuring machines, and robotic handling equipment. This class of equipment has recognizable auction value and is readily financeable through traditional secured lending channels.

- Other production and assembly equipment and tooling will be customized for the specific application. This equipment's value is based on the long-term viability of the products manufactured by the equipment and will not have traditional auction value. Financing for this type of equipment is more challenging. Funding solutions will be more limited in terms of availability and incorporate lower advance rates and higher costs.

- The added cost of tariffs could shift some of the production of machine tools currently in Europe and Asia to the United States. This shift would create additional demand for financing of new facilities, equipment, and incremental U.S.-based working capital.

- Working Capital Needs

- As production and assembly are moved back to the US, so are the related working capital financing needs. While the larger businesses will address these needs through their public financing vehicles, such as corporate bonds and commercial paper, the middle market participants will rely on secured credit facilities from commercial banks, independent and bank-owned ABL lenders, AR factors, and inventory lenders.

- Plain vanilla accounts receivable and inventory financing needs will be addressed by asset-based lending facilities provided by commercial banks, as well as independent and captive ABL firms.
- More specialized situations, such as smaller borrowing base monitored ABL facilities, as well as those situations characterized by higher customer concentration, more significant inventory levels, and those companies with historical or current financial challenges, will find their funding sources to be non-bank providers such as independent ABL lenders, AR factors, and inventory lenders.

■ Sourcing these funding solutions.

- Many of these middle-market funding solutions will be addressed through traditional commercial banking channels.
- However, as their funding needs require more credit availability to support the enterprise, businesses will find value in seeking non-bank sources for their working capital, equipment and owner-occupied real estate financing needs.
- While these non-bank sources can be accessed directly, many businesses will choose to utilize the services of a debt advisor specializing in middle-market funding solutions to assist in the process.
- The debt advisors have the market knowledge and relationships within the private credit sector to streamline the lender solicitation, selection, negotiation, and funding processes.

As a result of many influencing factors, we are entering into a phase of significant investment in manufacturing capacity within the U.S. This will involve U.S. companies re-shoring production that was previously outsourced to low-cost countries, as well as non-U.S. companies relocating production from foreign locations to the U.S. to avoid tariffs and other trade-related restrictions. The publicly announced investments are centered around the following industrial sectors: pharmaceuticals, semiconductor chips, energy, and data centers.

While these announcements are from Fortune 100 size companies that will address their capital needs through their public financing vehicles, such as corporate bonds and commercial paper, the middle market suppliers and service providers that support these larger businesses will need to rely on secured credit facilities from commercial banks, independent and bank-owned ABL lenders, AR factors, inventory lenders, equipment lenders and owner-occupied real estate lenders.

The secured finance community is well-positioned to address the varied funding needs associated with this re-shoring trend.

Tom Kessel is a principal with Glengarry Capital Group. He brings nearly 40 years of experience delivering debt solutions to middle-market businesses.

His background includes leadership positions in the commercial banking and capital markets business units at JPMorgan Chase (legacy Bank One and NBD), Fifth Third Bank, RBS Citizens Bank, and Wells Fargo Bank.

Kessel has delivered funding solutions in automotive components, specialty vehicles, manufacturing, building supplies, specialty finance, services, technology construction, and food and agriculture sectors.