

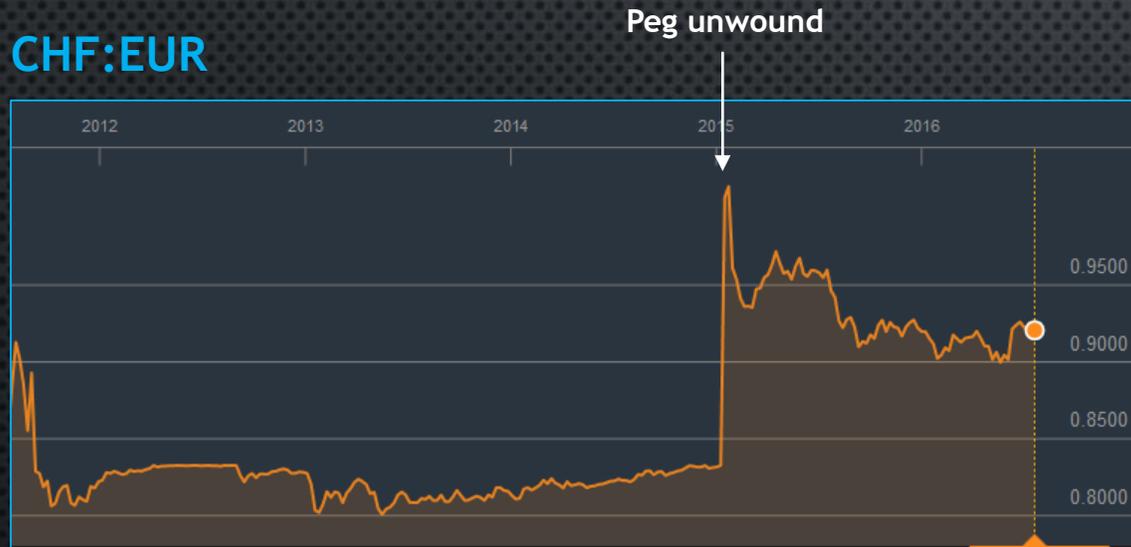
FOCUS ON FX RISK

Global multinationals are exposed to foreign exchange (FX) risk on a daily basis and even with adequate people and technology resources may struggle to manage it proactively.

Small domestic companies can see their competitive advantage eroded if foreign competitors benefit from favourable rates.

FX movements affect us all, and have done for centuries, but have received greater focus in recent years due to globalisation, automation in financial markets and intervention.

CHF:EUR



GBP:USD



Source: Bloomberg

IMPLICATIONS FOR CORPORATES

Businesses are exposed to FX risk, even if they do not realise it.

Translation

Occurs when a subsidiary's financial statements are converted from its local operating currency to the parent's base reporting currency. May impact the P&L, B. Sheet and Cash Flow statements of the parent, in turn affecting covenants. Companies may not hedge this risk due to its long-term nature and because hedging may create reporting distortions which affect comparability.

Transaction

Occurs on conversion of one currency to another, such as for sales, purchases, funding or dividends. The exposure is subject to mark-to-market accounting with the resulting gain or loss reflected in the P&L.

Economic

When FX movements make a company uncompetitive versus an international competitor, even if it operates only in its domestic market. As an embedded business risk it is hard to hedge.

Future

An exposure which will arise in the future, either already contracted, planned or unexpected.

Operational

The risk of loss resulting from inadequate or failed internal processes, people or systems. In this context might include incorrect data, misreading markets or misunderstanding hedging products.

IMPACT ON SHAREHOLDER VALUE

Unhedged FX movements may impact the Profit & Loss, B. Sheet and Cash flows.

In this simple example a UK company has to fund their subsidiary in Germany at EUR 1m per month for the next year **A**

Based on current GBP:EUR forward rates they have an unfavourable outlook, having to 'pay' GBP 838k in Dec 2013 rising to GBP 855k by Dec 2014 to cover the same EUR 1m **B**

For internal planning purposes they have budgeted 1.190 as the average GBP:EUR rate for the next year. Based on current forward rates that will result in a loss of GBP 56k over the period **C**

Payment Date	Amount	Cumulated Amount	FX Rate: Deal P/L Base	FX Forward Rate	Amount of Currency 2	Profit/Loss In Currency 1
13 Dec 2013	-1 000 000.00	-1 000 000.00	1.1900	1.1928	-838 366.55	1 969.58
13 Jan 2014	-1 000 000.00	-2 000 000.00	1.1900	1.1925	-838 608.58	1 727.55
13 Feb 2014	-1 000 000.00	-3 000 000.00	1.1900	1.1914	-839 315.87	1 020.26
13 Mar 2014	-1 000 000.00	-4 000 000.00	1.1900	1.1906	-839 927.92	408.21
14 Apr 2014	-1 000 000.00	-5 000 000.00	1.1900	1.1897	-840 580.30	-244.17
13 May 2014	-1 000 000.00	-6 000 000.00	1.1900	1.1888	-841 172.39	-836.26
13 Jun 2014	-1 000 000.00	-7 000 000.00	1.1900	1.1867	-842 678.82	-2 342.68
14 Jul 2014	-1 000 000.00	-8 000 000.00	1.1900	1.1843	-844 401.09	-4 064.95
13 Aug 2014	-1 000 000.00	-9 000 000.00	1.1900	1.1819	-846 074.52	-5 738.38
15 Sep 2014	-1 000 000.00	-10 000 000.00	1.1900	1.1783	-848 690.41	-8 354.27
13 Oct 2014	-1 000 000.00	-11 000 000.00	1.1900	1.1750	-851 068.29	-10 732.15
13 Nov 2014	-1 000 000.00	-12 000 000.00	1.1900	1.1713	-853 716.53	-13 380.40
15 Dec 2014	-1 000 000.00	-13 000 000.00	1.1900	1.1689	-855 532.68	-15 196.55

Source: TreasuryView

IF RATES RISE

Due to unforeseen macro events GBP Sterling moves in their favour, appreciating 10% against the Euro.

Assuming this shift is applied across the period, the company now have to 'pay' only GBP 762k in Dec 2013 rising to GBP 778k in Dec 2014 to cover the same EUR 1m **B**

For internal planning purposes their budgeted average rate of 1.190 for GBP:EUR would result in a profit of GBP 942k over the period **C**

Payment Date	Amount	Cumulated Amount	FX Rate: Deal P/L Base	FX Forward Rate	Amount of Currency 2	Profit/Loss In Currency 1
13 Dec 2013	-1 000 000.00	-1 000 000.00	1.1900	1.3121	-762 151.41	78 184.72
13 Jan 2014	-1 000 000.00	-2 000 000.00	1.1900	1.3117	-762 371.44	77 964.70
13 Feb 2014	-1 000 000.00	-3 000 000.00	1.1900	1.3106	-763 014.43	77 321.71
13 Mar 2014	-1 000 000.00	-4 000 000.00	1.1900	1.3096	-763 570.84	76 765.30
14 Apr 2014	-1 000 000.00	-5 000 000.00	1.1900	1.3086	-764 163.91	76 172.22
13 May 2014	-1 000 000.00	-6 000 000.00	1.1900	1.3077	-764 702.18	75 633.96
13 Jun 2014	-1 000 000.00	-7 000 000.00	1.1900	1.3054	-766 071.65	74 264.48
14 Jul 2014	-1 000 000.00	-8 000 000.00	1.1900	1.3027	-767 637.35	72 698.78
13 Aug 2014	-1 000 000.00	-9 000 000.00	1.1900	1.3001	-769 158.65	71 177.48
15 Sep 2014	-1 000 000.00	-10 000 000.00	1.1900	1.2961	-771 536.73	68 799.40
13 Oct 2014	-1 000 000.00	-11 000 000.00	1.1900	1.2925	-773 698.44	66 637.69
13 Nov 2014	-1 000 000.00	-12 000 000.00	1.1900	1.2885	-776 105.94	64 230.20
15 Dec 2014	-1 000 000.00	-13 000 000.00	1.1900	1.2857	-777 756.98	62 579.15

Source: TreasuryView

IF RATES FALL

However if GBP Sterling were to depreciate 10% against the Euro (as it did on Brexit) the position becomes unfavorable.

Assuming this shift is applied across the period, the company now have to 'pay' GBP 932k in Dec 2013 rising to GBP 952k in Dec 2014 to cover the same EUR 1m **B**

For internal planning purposes their budgeted average rate of 1.190 for GBP:EUR would result in a loss of GBP 1,276k over the period **C**

Payment Date	Amount	Cumulated Amount	FX Rate: Deal P/L Base	FX Forward Rate	Amount of Currency 2	Profit/Loss In Currency 1
13 Dec 2013	-1 000 000.00	-1 000 000.00	1.1900	1.0735	-931 518.39	-91 182.26
13 Jan 2014	-1 000 000.00	-2 000 000.00	1.1900	1.0732	-931 787.31	-91 451.18
13 Feb 2014	-1 000 000.00	-3 000 000.00	1.1900	1.0723	-932 573.19	-92 237.06
13 Mar 2014	-1 000 000.00	-4 000 000.00	1.1900	1.0715	-933 253.25	-92 917.11
14 Apr 2014	-1 000 000.00	-5 000 000.00	1.1900	1.0707	-933 978.11	-93 641.98
13 May 2014	-1 000 000.00	-6 000 000.00	1.1900	1.0699	-934 635.99	-94 299.86
13 Jun 2014	-1 000 000.00	-7 000 000.00	1.1900	1.0680	-936 309.80	-95 973.66
14 Jul 2014	-1 000 000.00	-8 000 000.00	1.1900	1.0658	-938 223.43	-97 887.30
13 Aug 2014	-1 000 000.00	-9 000 000.00	1.1900	1.0637	-940 082.80	-99 746.66
15 Sep 2014	-1 000 000.00	-10 000 000.00	1.1900	1.0605	-942 989.34	-102 653.21
13 Oct 2014	-1 000 000.00	-11 000 000.00	1.1900	1.0575	-945 631.43	-105 295.30
13 Nov 2014	-1 000 000.00	-12 000 000.00	1.1900	1.0542	-948 573.92	-108 237.79
15 Dec 2014	-1 000 000.00	-13 000 000.00	1.1900	1.0520	-950 591.87	-110 255.73

Source: TreasuryView

IF HEDGED

To hedge their risk the company trade an FX Forward, locking in their future Euro purchases at a rate of 1.1875 **A**. This provides certainty on monthly cash flows **B**

It also provides a cash flow profit of GBP 33k over the period, as they are locked at 1.1875 thus protected against the downside movement in GBP:EUR **C**

Please note that locking in means they cannot benefit from any upside in GBP:EUR above 1.1875 (hence it shows a loss in the months when rates are above this).

For simplicity reasons we do not consider hedge accounting in this example.

Payment Date	FX Rate	Amount of Currency 1	Amount of Currency 2	FX Forward Rate	Profit/Loss In Currency 1
13 Dec 2013	1.1875	-842 105.26	1 000 000.00	1.1928	-3 738.71
13 Jan 2014	1.1875	-842 105.26	1 000 000.00	1.1925	-3 496.68
13 Feb 2014	1.1875	-842 105.26	1 000 000.00	1.1914	-2 789.39
13 Mar 2014	1.1875	-842 105.26	1 000 000.00	1.1906	-2 177.34
14 Apr 2014	1.1875	-842 105.26	1 000 000.00	1.1897	-1 524.96
13 May 2014	1.1875	-842 105.26	1 000 000.00	1.1888	-932.87
13 Jun 2014	1.1875	-842 105.26	1 000 000.00	1.1867	573.56
14 Jul 2014	1.1875	-842 105.26	1 000 000.00	1.1843	2 295.83
13 Aug 2014	1.1875	-842 105.26	1 000 000.00	1.1819	3 969.25
15 Sep 2014	1.1875	-842 105.26	1 000 000.00	1.1783	6 585.14
13 Oct 2014	1.1875	-842 105.26	1 000 000.00	1.1750	8 963.02
13 Nov 2014	1.1875	-842 105.26	1 000 000.00	1.1713	11 611.27
15 Dec 2014	1.1875	-842 105.26	1 000 000.00	1.1689	13 427.42

Source: TreasuryView

HOW WE HELP

Key Capital can help you address FX risk in many ways.

Financial Strategy



We can create a financial strategy which minimises the impact of FX on your business and supports corporate strategy. Solutions can include maximising natural hedges and de-risking commercial contracts.

Treasury Management



We can ensure your funding, hedging and cash flow management are optimised for cost, flexibility and financial risk.

Hedging



Feasibility studies, document preparation, partner search and pricing checks to support your hedging programs.

Solution Sourcing



Sourcing an IT solution to help you manage and report proactively. We can help you scope requirements, run a ROI analysis and manage the implementation project.

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