WHY EXPORTERS USE FORWARDS

There’s a variety of FX strategies exporters can use to manage the risk of currency fluctuations when they earn revenue in foreign currency. The following example uses Forward Contracts, or Forwards.

Steph’s Grains Business exports grain and commodities globally, and revenue is in US dollars. She exports many contracts with small profit margins, so if exchange rates move, Steph’s profits could quickly disappear.

Steph’s risk management strategy is to book a Forward when she confirms a contract with her customer. Forwards book a set exchange rate for a specific amount, on a known future date.

Let’s say Steph agreed to export 350,000 US Dollars’ worth of wheat from Australia to Japan. Once the wheat is received in Japan in 3 months, the customer pays the agreed US dollar price. When Steph receives the payment, rather than converting into Aussie Dollars at whatever the market rate is, Steph uses her previously booked forward to exchange 350,000 US Dollars into 500,000 Australian Dollars at the agreed rate of 0.7.

Without a forward in place, if the Aussie dollar appreciated to 0.7250, Steph’s US dollar income would only be worth $483,000 and this means Steph’s profit would be $17,000 less.

With a large number of invoices and small profit margins, Steph books a forward for each invoice, so currency risk is one less thing to worry about. She understands that she won’t be able to convert the funds at a lower spot rate if the Aussie Dollar depreciates against the US Dollar, but is comfortable knowing she is not exposed to an appreciating Aussie Dollar.

Other exporting businesses with different cashflow models and different risk profiles use Forwards for either a portion of foreign currency invoices*,* or alternatively book a bulk forward then pre-deliver individual contracts over time, as foreign revenue is received.

In summary, Forwards are just one technique for exporters managing cashflow in a successful risk management strategy.

To learn more and see how a Risk Management strategy can work for your business, speak to your Markets Specialist or Business Banker.

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