WHY USE FORWARDS?

We’ve looked at what an FX Forward Exchange Contract is and how it works.

Let’s now dive deeper into why importer businesses typically use forwards for their business and costings.

You’ll likely recall that a Forward is an agreement to exchange currencies for a set amount, at a known date in the future for a known rate.

Let’s have a look at:

1. An importer buying stock from China every month,
2. A business purchasing a new piece of equipment with instalment payments,
3. A supplier with agreed cost prices for the next 12months
4. **Consistent Containers from China**

Breana’s Luxury Bags import direct from China and pay in USD. She has monthly orders for containers with a spike in demand in the middle of the year. Breana has healthy profit margins, but does not want to wait until her payments are due to simply buy her foreign currency at the rate of the day.

**Strategy**: Breana books 50% of her anticipated USD payments, in the form of 12 different monthly forwards. These forwards, on 12 different dates give her a known AUD cost for half her monthly FX payments. When Breana makes each payment to China she uses a SPOT for the remainder of each payment.

1. **New Equipment Fit Out from America**

Antonio’s Media Production company purchases new audio-visual equipment from America. He agreed terms on the US$1m price, so that 10% payment is made on the order date, 40% payment is made on shipment, and the 50% balance is sent when the equipment arrives in Australia.

**Strategy**: By booking two forwards, for the full face value of the future dated payments, Antonio knows the exact cost in AUD for the new equipment, regardless of where the exchange rate moves over the next 3 months.

1. **No Room to Move**

Briony’s Yoga Equipment, has a 12month contract to supply a national Department store chain with Yoga mats, at an exact AUD price. Briony imports mats from Finland in Euro, and she has a small profit margin built into the contract. There is no opportunity for Briony to reprice in the next 12months, so if the AUD weakens she cannot pass on the extra cost. This means currency changes are fully absorbed in her profit margins.

Here’s how Briony’s monthly Cost of Goods Sold could look as the exchange rates move, and if she is 100% unhedged, that is only buying currency on the day that she needs.

**Strategy**: Briony books 100% of her agreed volumes for the next 12months, to lock in her cost of goods sold, and protect her profit margin until the next contract allows her the opportunity to revisit the terms.

**Conclusion**

As currency markets are constantly moving, your profit margins don’t have to absorb all the movements, to manage this risk.

A forward works best when used to protect importers from a weakening Aussie dollar, however if the Aussie dollar appreciates, then a forward doesn’t allow you to participate, because your exchange rate is locked in. The balance between certainty of costs, and exposure to currency fluctuations is unique to your business, so the best FX strategy is one tailored to your specific circumstances.

Business volume and turnover can be volatile and there may be a need for you to amend your forward contract during the term of the contract. Whilst this is possible, there may be a cost to close out part or all of the contract. The proportion of your FX needs that you choose to hedge with a forward contract will be unique to your business.

For information on FX risk, please contact your Business Banker or Markets specialist on 1300 960 355.

NAB. More than money.

Examples are for illustrative purposes only and do not reflect current prices or outcomes. The information provided  in this video is intended to be of a general nature only. It has been prepared without taking into account your objectives, financial situation or needs. Before acting on the information in this video, National Australia Bank Limited (ABN 12 004 044 937, AFSL and Australian Credit License 230686) (NAB) recommends that you seek independent advice to determine whether such information is appropriate for your objectives, financial situation and needs. NAB recommends that you obtain and consider the relevant Product Disclosure Statement or any other disclosure documents (as applicable) available from NAB, and seek independent advice before making any decisions regarding the products and services mentioned to in the video including whether to acquire or use, or to continue to hold or use, a product or service mentioned.