"How SMEs can secure their profit margin from FX volatility AND pocket their currency buffer"

Problem

SMEs doing cross-border business are exposed to currency risk. To protect their profit margin from adverse currency fluctuations, instead of hedging, many SMEs add a **"currency safety buffer"** of a few percentage points on top of their profit margin. However, when currency volatility increases, as experienced frequently over the last 10 years, the currency buffer may not suffice, and SMEs' profit margin can be eaten away or even wiped out.

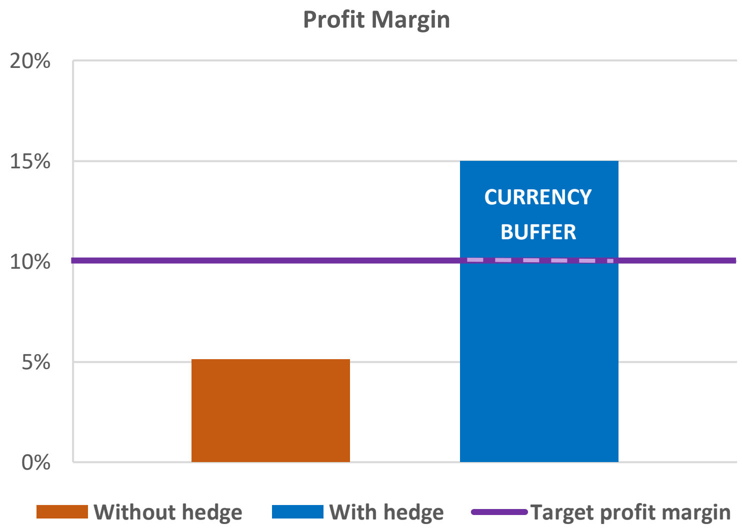
Solution

By using **Currency Futures** contracts, as implemented in SystematicEdge's turn-key hedging solution, SMEs can eliminate their FX risk, making their profit margin insensitive to currency fluctuations. As a result, the currency buffer becomes unnecessary and **SMEs using Futures hedging can either keep the buffer as extra profit margin (increasing profitability) or remove the buffer and lower their selling prices (improving competitiveness).**

Example

A trading company, whose accounting currency is US$, purchases goods in Europe for €1,000,000 (payment terms of 6 months). The company sells to its clients in US$ and is thus exposed to the EUR-USD currency risk. To cover the risk, the company adds a **currency buffer** of 5% to its **target profit margin** of 10%. In this example, we simulate the EUR-USD exchange rate to increase from 1.12 at T0 (when the company buys the goods) to 1.25 at T0 + 6 months (when the company pays its supplier).

We can see that, in that situation, the currency buffer is not enough, the company's actual profit margin being reduced to 5%. However, if it hedges its currency risk using **Currency Futures**, the company can lock in the exchange rate of 1.12 at T0 and therefore secure its target profit margin of 10% while **pocketing the currency buffer** of 5%, thus enjoying an actual profit margin of 15%.



At T0	
EUR-USD exchange rate	1.12
Purchasing cost in EUR	1,000,000
Purchasing cost in USD	1,120,000
Target profit margin	10%
Currency buffer	**5%**
Selling price in USD	1,317,647
At T0 + 6 months	
EUR-USD exchange rate	1.25
Currency move	+11.6%
Payment to the supplier in EUR	-1,000,000
Case A: Without FX hedge	
Payment to the supplier in USD	-1,250,000
P&L in USD	**67,647**
Actual profit margin	**5%**
Case B: With FX Futures hedge	
Payment to the supplier in USD	-1,250,000
FX risk immunization in USD	130,000
P&L in USD	**197,647**
Actual profit margin	**15%**

CONTACT US alain.groshens@systematicedge.com +852 6194 1068 Systematicedge.com

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