



Contingent FX Hedge – Cross-Border Infrastructure Acquisition

Scenario Type: Infrastructure – Cross-Border Acquisition (Pre-Completion Phase)

Asset Class: Core Infrastructure (Transport / Utilities / Regulated Assets)

Situation Type: Competitive offshore acquisition with conditional FX exposure between bid and completion

Primary Issue: Structural FX execution risk during bid-to-close phase, where conventional hedging tools force unacceptable break-risk or loss of bid credibility

1. Decision Context

The fund is pursuing a material offshore infrastructure acquisition via a competitive auction process.

The purchase price is denominated in foreign currency, while equity capital is funded in AUD. The bid process spans several months and includes multiple conditional milestones prior to completion.

From the seller's perspective, FX certainty is required for a credible offer.

From the buyer's perspective, committing to a vanilla FX hedge prior to deal certainty creates unacceptable downside if the transaction fails.

The IC decision is **not whether the asset is attractive**. It is whether FX exposure during the bid-to-completion window can be governed **without embedding a material loss on a non-completed transaction**.

This is not a portfolio FX decision. It is a **deal-execution and governance decision**.

2. What Changed

At bid initiation:

- No historical offshore acquisition exposure
- FX risk treated as a timing issue rather than an execution risk
- No framework for conditional commitment or break-risk tolerance
- Treasury tools assumed certainty of drawdown

As the process evolved:

- Bid credibility became dependent on FX certainty
- Deal probability changed discretely at milestones, not continuously
- Vanilla forwards introduced asymmetric unwind risk

- Options impaired deal economics at required scale
- FX risk migrated from pricing input to execution constraint

The transaction advanced. The FX framework did not.

3. How the Risk Actually Manifests

The failure mode is not FX volatility. It is **asymmetric loss under deal uncertainty**.

- FX risk is highest when deal certainty is lowest
- Vanilla hedges create large unwind losses if the deal fails
- Unhedged exposure undermines bid credibility
- Margin and liquidity stress can surface during closing windows
- IC is forced to approve implicit tail losses on a failed deal

What should be a controllable execution variable becomes a source of governance fragility.

4. What Surfaces on Review

When assessed structurally, consistent issues emerge:

- FX exposure is treated as static despite milestone-based probability
- Break-risk is understated or ignored in IC materials
- Hedging is sized to headline value, not net economic exposure
- Natural hedges (debt, existing FX assets) are overlooked
- Sellers reward certainty, not just headline price
- Treasury instruments are misaligned with transaction mechanics

This is not a pricing error. It is a **structural mismatch between deal process and hedge design**.

5. Structural Assessment

This is not:

- A currency view
- A valuation problem
- A hedging sophistication gap

It is:

- A transaction-stage risk architecture problem
- A break-risk governance issue
- A sequencing failure between commitment and certainty

Any solution must preserve:

1. Bid-stage FX certainty
2. Capped downside if the deal fails

3. Clean transition into execution-stage hedging
4. Liquidity and collateral resilience under time pressure

6. Structuring Logic

Effective remediation focuses on **hedging commitment, not currency**.

Key principles:

- Align FX commitment with deal milestones, not bid submission
- Use contingent structures that activate only when certainty increases
- Cap downside prior to trigger rather than eliminate FX exposure
- Size hedges to net economic conversion, not headline EV
- Integrate collateral and CSA behaviour into the deal timeline
- Remove discretionary decision points at critical moments

The objective is not to eliminate FX risk. It is to **prevent FX from vetoing execution**.

7. Intended Outcomes

When structured correctly:

- Bid credibility matches local-currency competitors
- Break-risk is capped and pre-approved
- Deal economics remain inside hurdle tolerances
- Margin and liquidity behaviour is predictable through closing
- FX becomes a governed execution input, not a last-minute shock

The fund competes on asset fundamentals, not FX survivability.

8. IC Takeaway

This was not an FX problem in the portfolio sense.

It was the predictable result of applying **binary hedging tools to a conditional transaction**.

Cross-border acquisitions fail quietly when FX certainty cannot be demonstrated – or fail loudly when hedges crystallise losses on deals that never close.

Contingent hedging restores control by aligning commitment with certainty.

9. Applicability

Most relevant where:

- FX exposure arises during bid-to-close, not operations
- Auction processes reward execution certainty
- FX moves of 2–5% are IRR-material
- Vanilla options are uneconomic at required scale
- Natural hedges can reduce net exposure
- IC approval requires bounded downside on failure

Less relevant where:

- Purchase price is already locally funded
- Timing is flexible and bilateral
- FX risk can be warehoused without consequence
- Milestones cannot be objectively defined

10. Engagement Path

Primary Offer: Derivatives Portfolio Review™ – Transaction FX & Execution Review
Deal-stage FX risk mapping, break-risk containment, contingent hedge design, and governance framework.

Secondary / Bespoke: Milestone trigger drafting, natural hedge integration, CSA and margin design, seller-facing financing certainty narrative.

A full structural narrative is available for readers who wish to review the underlying mechanics, trade-offs, and remediation sequencing in greater detail.

Disclaimer

Illustrative scenario for discussion purposes only. Not a transaction summary or client-specific case study.