PARA BELLUM ADVISORS

DIRECT CAPITAL PRINCIPAL · MULTI-CURRENCY OPERATING GROUP

FX Architecture for a Principal with Australian and ASEAN Operating Businesses

SCENARIO TYPE	Direct Capital Principal – Brisbane-based with ASEAN operations
ASSET CLASS	Multi-currency operational FX exposures, USD and local currency revenues
RISK FOCUS	Unmanaged operational FX risk, timing-instinct hedging, no ISDA documentation, governance absent
PRIMARY OFFER	Derivatives Portfolio Review™
RELEVANT SERVICES	FX exposure mapping · Hedging policy framework · ISDA and CSA setup · Instrument selection and execution guidance · Ongoing monitoring framework

THE SITUATION

The principal had spent a decade building a group of businesses with operations in Australia, Vietnam, and Indonesia. The Australian entity generated revenue in AUD. The offshore businesses generated revenue in USD and local currencies. Intercompany funding flowed both ways depending on where capital was needed.

On paper, the group was profitable and growing. In practice, a meaningful portion of the profitability was being eroded by currency movements that nobody was formally managing.

The informal approach was timing. When the AUD was weak, the principal delayed repatriating USD earnings. When the AUD was strong, he moved money quickly. This was instinct, not policy. It worked some of the time. It had also, in two specific years, produced repatriation decisions that were materially worse than a simple forward hedge would have delivered.

The principal's accountant had advised him that hedging was complex and risky. That advice was not wrong in the abstract. It was wrong for this situation – because the actual risk was the unhedged position, not the hedge.

HOW THE PROBLEM COMPOUNDS

Multi-currency operational businesses accumulate FX exposure in ways that are easy to ignore when the currency environment is benign. The exposure does not appear on the balance sheet in a way that creates governance pressure. There is no mark-to-market. There is no margin call. There is just a lower profit figure at year end that gets attributed to conditions rather than to an absence of management.

The intercompany structure added complexity. Loan accounts between entities had been used to manage cash flow across the group – some denominated in AUD, some in USD, some in whichever currency happened to be convenient at the time. The resulting exposure was complex and partially self-offsetting in ways that were difficult to map without dedicated analysis.

By the time this engagement began, the principal had a reasonable sense that he had a currency problem. He did not know the size of it, the direction of it, or where it sat within the group structure.

WHAT TYPICALLY BREAKS

Exposure mapping done incorrectly

Without a clear map of where currency risk sits – including intercompany positions, deferred receivables, and capital account flows – any hedging programme is built on incomplete information. The hedge that looks right in the P&L may be doing nothing useful, or creating a double-up elsewhere.

No ISDA documentation

ISDA master agreements and CSAs are required to transact OTC FX instruments with a bank. Accepting bank-standard documentation without review means accepting threshold arrangements, eligible collateral definitions, and close-out mechanics that may not be appropriate for the business.

Timing instinct masquerading as policy

A hedging approach that depends on a single person's judgement about currency timing is not a policy. When that person is unavailable, or when moves are large enough that the decision becomes emotionally charged, the approach fails.

Bank conversations that sell rather than advise

Both relationship banks had pitched FX products. Both conversations left the principal with the impression he was being sold something. That scepticism was well-founded. Bank FX sales conversations are product conversations, not exposure conversations.

THE STRUCTURAL INSIGHT

FX risk in a multi-entity operating group is not one problem. It is several.

There is transaction exposure on known near-term cash flows: invoices, intercompany transfers, debt service. This is the most straightforward to hedge and the most clearly justified.

There is translation exposure on the balance sheets of offshore entities. Less urgent to hedge but important to understand and monitor.

There is economic exposure on the longer-term competitive position of the businesses – real but difficult to hedge directly.

The engagement started with mapping, not with instruments. A full exposure map across the three jurisdictions – including intercompany loan positions – took the better part of two weeks to construct properly. What emerged was a clear picture of where the real risks sat, which risks were already naturally offsetting within the group structure, and where hedging would actually add value.

Near-term USD cash flows were hedged with rolling short-dated forwards, matched to the actual repatriation schedule rather than round numbers, at seventy per cent of forecast earnings to avoid over-hedging. Intercompany loan positions were restructured so that natural currency offsets within the group were made explicit rather than accidental. ISDA documentation was established with one primary banking counterparty, with terms negotiated rather than accepted as presented.

INTENDED OUTCOMES

- Group FX exposure mapped and understood – the principal stopped making ad hoc repatriation decisions under pressure and started managing currency as a normal business function.
- Hedging programme executing against a documented policy rather than timing instinct – not dependent on any single person's availability or judgement.
- ISDA documentation in place – the principal can transact instruments with a bank without accepting terms he has not reviewed.
- Reduction in earnings volatility from currency measurable in the first full year of operation.
- Accountant has a framework to work within on the tax treatment – no longer advising that hedging is complex and risky without being able to say what should be done instead.

WHERE THIS APPLIES

Most relevant where a principal has material revenue or assets in multiple currencies; the current approach is timing-based or entirely unmanaged; the adviser circle has no derivatives documentation or hedging experience; and there is genuine earnings volatility that would be reduced by a structured programme.

Less relevant where cross-border cash flows are small relative to overall earnings; natural hedges within the business are already working effectively; or the operating businesses are not sufficiently stable to forecast the exposures that a hedging programme requires.

TYPICAL ENGAGEMENT PATH

Derivatives Portfolio Review™ – FX exposure mapping and hedging architecture.

Secondary: Hedging policy documentation, ISDA and CSA negotiation support alongside legal counsel, instrument selection and execution guidance, and ongoing monitoring framework.

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