**Blades, Inc. Case-1**

Blades, Inc., is a U.S.-based company that produces a single type of product, roller blades, “Speedos,”. Blades is currently exporting roller blades to Thailand. Its primary customer there, a retailer called Entertainment Products, is committed to the purchase of 200,000 pairs of Speedos annually for another three years at a fixed price of 4,600 Thai baht per pair. When that agreement ends, it may be renewed by Blades and Entertainment Products.

Blades is also importing materials such as rubber and plastic components sufficient to manufacture 80,000 pairs of Speedos annually from Thailand. These imports are denominated in baht, and the price depends on current market prices for these components.

As a result of increased competition from various Thai roller blades manufacturers, and the recent fluctuation in Thai baht. Blades has recently decided to expand its international trade relationship by exporting its roller blades to the United Kingdom with more stable currencies. Jogs, Ltd., a British retailer, has committed itself to the annual purchase of 240,000 pairs of Speedos, Blades’ primary product, for a price of £80 per pair. The agreement is to last for two years, at which time it may be renewed by Blades and Jogs.

Under the two export arrangements, Blades sells 60,000 and 50,000 pairs of Speedos to Jogs and Entertainment Products, respectively, in each quarter. Payment for these sales is made on the first of January, April, July, and October. The annual amounts are spread over quarters to avoid excessive inventories for the British and Thai retailers. Similarly, to avoid excessive inventories, Blades usually imports materials sufficient to manufacture 20,000 pairs of Speedos quarterly from Thailand. Although the payment terms of its arrangements with the Thai suppliers call for payment within 60 days of delivery, Blades generally pays for its Thai imports upon delivery on the first day of each quarter so as to maintain its trade relationships with the Thai suppliers. Blades believes that early payment is beneficial, as other customers of the Thai suppliers pay for their purchases only when it is required.

Because Blades is relatively new to international trade, Ben Holt, Blades’ chief financial officer, is concerned about the potential impact of exchange rate fluctuations on Blades’ financial performance. Holt is vaguely familiar with various techniques available to hedge transaction exposure, but he is not certain whether one technique is superior to the others.

Holt would like to know more about forward, money market, and option hedges and has asked you, a financial analyst at Blades, to help him identify the hedging technique most appropriate for Blades. Unfortunately, no options are available for Thailand, but British call and put options are available. Holt has provided you with the following information for Thailand, the United Kingdom, and the U.S.:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Thailand** | **U.K.** | **U.S.** |
| Current spot rate | $0.0230 | $1.50 |  |
| 90-day forward rate | $0.0215 | $1.49 |  |
| Put option premium | Not available | $0.020 per unit |  |
| Put option exercise price | Not available | $1.47 |  |
| Call option premium | Not available | $0.015 per unit |  |
| Call option exercise price | Not available | $1.48 |  |
| 90-day borrowing rate (nonannualized) | 4% | 2% | 2.4% |
| 90-day lending rate (nonannualized) | 3.5% | 1.8% | 2.2% |

 Holt has also identified the following probability distributions for the exchange rates of the British pound and the Thai baht in 90 days:

|  |  |  |
| --- | --- | --- |
| **Probability** | **Spot rate for British pound in 90 days** | **Spot rate for Thai baht in 90 days** |
| 5% | $1.45 | $0.0200 |
| 20 | $1.47 | $0.0213 |
| 30 | $1.48 | $0.0217 |
| 25 | $1.49 | $0.0220 |
| 15 | $1.50 | $0.0230 |
| 5 | $1.52 | $0.0235 |

Blades’ next sales to Thailand and the United Kingdom, and purchases from Thailand will occur one quarter from now. If Blades decides to hedge, Holt will want to hedge the entire amount subject to exchange rate fluctuations. Currently, Holt expects the imported components from Thailand to cost approximately 3,000 baht per pair of Speedos. Holt has asked you to answer the following questions for him:

1. Using a spreadsheet, compare the hedging alternatives for the Thai baht with a scenario under which Blades remains unhedged. Do you think Blades should hedge or remain unhedged? If Blades should hedge, which hedge is most appropriate?
2. Using a spreadsheet, compare the hedging alternatives for the British pound receivables with a scenario under which Blades remains unhedged. Do you think Blades should hedge or remain unhedged? Which hedge is the most appropriate for Blades?
3. In general, do you think it is easier for Blades to hedge its inflows or its outflows denominated in foreign currencies? Why?
4. Could Blades modify the timing of the Thai imports to reduce its transaction exposure? What is the trade-off of such a modification?
5. Could Blades modify its payment practices for the Thai imports to reduce its transaction exposure? What is the trade-off of such a modification?
6. Holt is also considering importing components from Japan as the prices are low enough, and more importantly, he thinks it would reduce Blades’ baht exposure by taking advantage of the recently high correlation between the baht and the Japanese yen. Do you think his plan will reduce Blades net transaction exposure? Why or why not? (Discuss the effect in short run vs in the long run)