

Created by: Trustan Kekauoha

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Executive Summary

This memo evaluates the company's foreign exchange risk from a €8,000,000 receivable due in one year and outlines potential hedging strategies. The EUR/USD spot rate is 1.17, with a one-year forward of 1.0890. Because our company reports in USD, if the euro weakens, the USD amount we receive will be lower than expected. Three common hedges are considered: forward contracts, money market hedges, and currency options. Using a hedge is recommended to protect profits and guide the next stage of analysis.

Background and Objectives

Our U.S. based pharmaceutical exporter expects to receive €8,000,000 in one year. At the current spot rate (1.17), this is about \$9.36 million. If the euro falls to 1.05, USD proceeds fall to about \$8.4 million. The main objective is to explore strategies to manage foreign exchange risk and protect the USD cash inflow. We also need to recommend a cost effective/flexible hedge that fits with the company's overall risk management and strategy.

Methods

Three hedging strategies are:

- Forward Contract: locks in a fixed exchange rate
 - Pros: No upfront cost; removes foreign exchange risk
 - Con: No benefit if the euro goes up
- Money Market Hedge: uses USD and EUR borrowing/lending at current rates (USD 4.25%, EUR 2.15%)
 - Pros: removes foreign exchange risk; predictable outcome
 - Con: requires capital and setup
- Currency option (EUR Put / USD Call): right to sell euros at a set rate
 - Pros: protects against losses; allows gains if euro strengthens
 - Cons: Premium of \$0.021; may expire unused

Limitations & Next Steps

Analysis assumes stable interest rates and no major market shocks. Actual forward and option rates may vary.

Next steps: build a spreadsheet model to evaluate each hedge, implement it in Excel, and use it to compare outcomes. AI prompt engineering may assist model creation. Final analysis will guide the hedge choice, considering cost, risk protection, and flexibility.

References

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