MONEX

Case Study Private Equity Funds — Solutions to Manage Cross-border Investments + Capital Calls

Monex USA is a global financial institution focusing exclusively on Foreign Exchange and Global Payment solutions. We offer tailored FX hedging strategies, including derivatives, access to deep liquidity in both major and emerging markets, and streamlined account services featuring flexible credit, efficient onboarding, and seamless cross-border payments. Recognized as a top-ranked FX forecaster, Monex also provides a robust suite of research products.

The following case study illustrates how Monex USA can help clients save money by taking advantage of the FX market.

Scenario:

A US-based Private Equity Firm commits to a cross-border investment in Germany that will close in 2 months. With this acquisition, the firm submits a 15-day capital call notice to their Limited Partners, of which 80% are US-based, and 20% is denominated in a Canadian-based currency share class.

FX Exposure:

In this scenario, the fund will have exposure to the Euro to acquire the investment and the Canadian dollar through a capital infusion denominated in local currency from their Canadian-based LP.

Solution 1: Using Forward Contracts

To minimize currency exposure, the fund puts on the following forward hedges for a EUR€200M investment and a CAD$40M capital call.

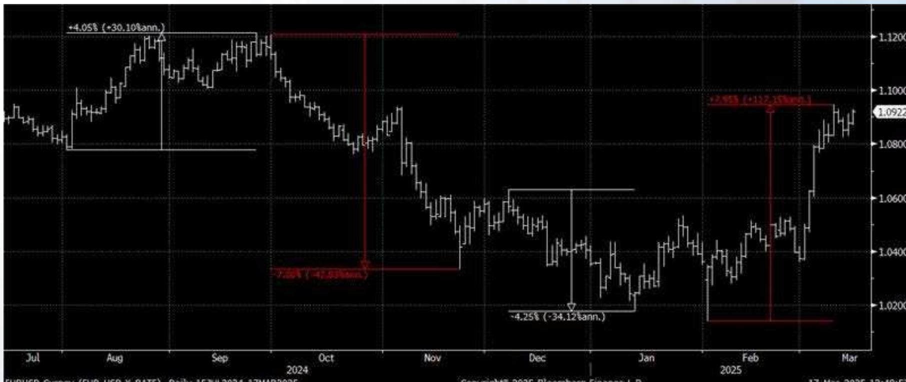
Hedge details (Spot ref EUR/USD@1.0826, USD/CAD Spot ref @1.4293):

- Buy EUR €200M / sell USD $216.9M at contract rate 1.0845 for 60-day maturity.
- Buy USD $40M / sell CAD $57.084M at contract rate 1.4279 for 15-day maturity.

EUR/USD Outcome:

The euro appreciated by 2.5% in the 60-day time frame between bid acceptance from 1.0826 to 1.1096. Hence, the difference in USD notional for an equivalent €200M Euros moves from USD$216.52M to $USD221.92M. By placing the forward hedge over 2 months, the forward rate of 1.0845 (USD notional of $216.9M), the fund reduces the need for an additional liquidity injection of $5.02M.

The euro depreciated by 2.5% from 1.0826 to 1.0555. The USD notional for €200M moves from USD $216.52M to USD $211.1M. Here, less dollars will be needed to purchase the asset. The fund would be left with USD $5.42M of un-deployed capital, creating a potential IRR under-performance.



Source: Bloomberg (7/24 - 3/25) indicating 4-8% currency movements in various 60 day windows

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USD/CAD Outcome:

The CAD appreciated by 1.8% to 1.4041 within the 15-day time period. The initial amount of CAD was hedged at a forward rate of 1.4279 to CAD $57.084M, but if the fund had left this capital to the market, this amount would have equaled CAD $56.164M. Hence, the fund would be left with CAD $0.92M if they hadn't hedged. This creates the problem of undeployed capital, reducing IRR and/or the issue of returning funds to LP's, often creating operational burdens and additional costs.

Source: Bloomberg (8/24-3/25) indicating 1.5-2.5% volatility in various 15 day windows

The CAD depreciated by 1.8% to 1.4550. When converted to dollars, the initial CAD $57.084M is now worth USD $39.233M. Without hedging, the fund would have been short USD $0.767M and would require an additional capital call or access to a bank facility to fund the shortfall.

Solution 2: Using Options

Vanilla Option:

Buy a EUR Call/USD Put strike 1.0862 ("At the Money Forward") with a 2-month expiry. The cost of the option is 1.3000% of the notional amount.

The fund has 100% protection above strike up to the cost of the premium. On the other hand, if the EUR depreciates, the fund has access to spot and can purchase full notional at a more advantageous rate.

At or above 1.0862 "strike rate", the fund executes full notional €200M at 1.0862 "Strike rate" more favorable than the market at expiry.

Below 1.0862 "strike rate", the option expires worthless and the fund can execute in the spot market at more favorable rates.

*"Even though FX is a **small part** of my business, it has a **big impact** on our bottom line. Its comforting to know Monex USA is always keeping up with the **(FX) market** for me."*

Collar Option:

Buy a EUR Call/USD put strike 1.0895 and sell a EUR Put/USD Call strike 1.0640 with a 2-month expiry. Combined strategy costs .6500% of the notional amount.

The fund has full protection at the higher strike rate with upside participation in the market to the lower strike rate. Upside potential is capped by selling a EUR put, with a reduced premium compared to the vanilla option.

Above 1.0895, the Fund will execute at a "higher strike rate" full notional €200M at a hedged rate better than the spot market.

In between 1.0895 and 1.0640, the option expires worthless. The fund has access to the market at a more favorable spot rate than the hedged rate.

At or below 1.0640, the Fund is required to execute at 1.0640, a better rate than the original hedge but worse than the market.

For informational purposes, the same strategies can be replicated for Canadian exposure using shorter-dated expiries.

Contact Monex USA's Institutional Team today to learn how we can help your fund manage FX exposures and optimize global transactions.

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