MANAGING CURRENCY RISKS IN CROSS-BORDER M&A

The strength of the dollar, a favorable interest rate environment and an abundance of cash on hand may make this a good time for domestic companies to invest outside the U.S. However, companies considering a cross-border merger or acquisition should evaluate the currency risk during the due-diligence stage of the deal to ensure that currency rate volatility does not adversely affect the target price.

You can perform a “Value at Risk” analysis to quantify the currency risk between now and the time of closing by multiplying the amount of foreign currency that you will need to acquire the target, times the volatility factor for the particular currency.

You should then evaluate the various hedging products that are available to help manage the risks you have identified, including forward contracts, option contracts, currency swaps and cross-currency interest rate swaps. After that evaluation, the selection of a specific hedging strategy requires matching the hedging product to the deal specific risk.

Hedges of anticipated M&A activity do not qualify for hedge accounting treatment. Derivative mark-to-market adjustments will need to be made to your P&L statement.

As you evaluate your risk, consider the following questions:

1. How are you funding the investment? With cash or leverage?
2. What is the currency mix of the free cash flow the acquisition will generate?
3. What is the target’s price and currency denomination?
4. How likely is it that the deal will close? How long will it take to close?

HEDGING ROADMAP

Through basic deal analysis and the application of the appropriate hedge products, currency risk can be identified and reduced.

For more detailed information on this topic, view the related video “Managing Currency Risks in Cross-Border M&A” at pnc.com/ideas, contact your foreign exchange advisor or

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