Case Study

Blue Fashion

BLUE BUNGALOW

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Customer for Over 3 Years

Company Overview

Blue Fashion is a women's clothing line based in Australia. Two years ago, the company expanded offshore. Revenues reached AU$ 10 million annually, with 70% of sales denominated in USD and the balance in AUD.

As the clothing is manufactured primarily in China, the incoming USD revenue acts as a natural hedge against AUD/USD volatility. U.S. dollars were held in Blue Fashion's account until invoices were due to be paid or until they needed to convert USD to Aussie for operating expenses. All transactions were done as spot—simply paid out or converted at the prevailing rate.

The USD pricing for the clothing had been based on the USD/AUD conversion at the time of the expansion, which gave them a de facto budget rate of $0.775. This structure yielded a projected gross margin of 60%.

The Challenge

Australia has a great deal of exposure to the U.S. dollar because of its proximity to China; China and the U.S. have historically been Australia's top two trading partners.

With the onset of the U.S.-China trade wars in early 2018 and the slowdown in the Chinese economy, the Aussie started declining against the U.S. dollar. Spot pricing slipped to around $0.68 in 2019, which meant Blue Fashion were realising more Aussie on every conversion from USD and increasing their gross margins. A good problem to have, certainly, but the question became one of maintaining these higher margins in a volatile market.

The Solution

With continuing USD strength and 70% of their exposure in the stronger currency, Blue Fashion wanted to lock in the higher margins and add certainty to their costs and revenues. Maintaining the clothing lines' pricing structure, yielding an effective budget rate of $0.775, gave the company headroom if the Aussie started to strengthen.

We proposed a Window Forward Extra, a zero-premium structured product. Like a Window Forward, this contract can be drawn down over time. Unlike a forward contract, though, the Window Forward Extra defines a "worst case" rate as the barrier and allows for upside if the currency moves in the client's favour. The contract is structured to lock the margins for a full year, with 12 monthly expiries.

We set a ''protection' ('worst case') barrier, of USD/AUD $0.69 and a strike, or knock-in, price of $0.654 for converting USD to AUD.

The Results

This structure provides peace of mind and certainty about costs, while allowing the client to take advantage of continued U.S. dollar strength for 12 months ahead. It also means the client can protect the gains on gross margin. The Window Forward Extra expands the gross margin rate by 12% or more, from an average of 60% to a range of 71-76%, depending on the pricing at each contract's expiry.

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