FX Risk Advisory for Life Science & Healthcare

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Why passive FX management falls short

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Key takeaways

Foreign exchange (FX) risk affects global companies and can be material to cash burn and other financial results.

For companies in the life science and healthcare sectors (LSHC), the impact can be especially pronounced as exposure horizons may extend to several years, and the degree of natural currency diversification is low.

Active management of FX, through the deployment of natural remedies or derivatives, can help stabilize performance, enable more confident planning, and minimize maximum regret.

Global corporations incur currency risk somewhat by accident. It's a byproduct of doing business or investing internationally, created the moment the decision is made on the overseas destination for clinical trials or R&D facilities. Currency risk cannot be destroyed — it can only be dealt with, managed, and transferred. Unfortunately, it is often ignored.

What is passive FX management?

Most innovation sector LSHC companies buy or sell currencies only when triggered by operational needs. In fact, 7 of 10 engage in this practice according to a recent SVB survey based on the general FX strategies and practices of 124 companies in the SVB LSHC client portfolio[1].

The cost of an unexpected rate change is absorbed by the business, as are the gains, handled like tourists waiting to buy euros until they are actually in Europe. This approach is passive FX management.

What's wrong with buying currency as you need it?

By a 9-to-1 ratio, LSHC companies move money in one direction, out of the US to fund global operations[1]. This results in significant undiversified currency risk such that a passive strategy may not be enough; undiversified because revenues have either not been established or are denominated primarily in USD or in currencies such that there are no offsetting expenses.

Currencies move, and they can move against you, with trends often lasting longer than expectations. In this case, a weakening in the USD decreases its purchasing power, leading to faster cash burn and shorter runways. And, the tide has indeed turned against the USD[2].

[1] SVB FX Risk Advisory paper: https://www.svb.com/blogs/ivan-asensio/fx-risk-advisory-currency-management-insights-for-life-sciences-healthcare-companies
[2] SVB FX Risk Advisory paper: https://www.svb.com/blogs/ivan-asensio/how-2020-accelerated-currency-trends-and-whats-ahead

Similarly, at later stages when LSHC firms have commercialized, foreign currency-denominated assets, expected cash flows and future unpaid dividends are also at risk of losing value in USD terms. A fall in foreign currencies will affect key business management metrics, including topline revenue, EBITDA (Earnings Before Interest, Tax, Depreciation and Amortization), and sales margins. The impact may be high enough to be material, ultimately jeopardizing the valuation of the company.

Active FX management can reduce risk

Active FX management is about awareness, analysis and quantification. The rule of thumb is to exhaust all the natural risk mitigation alternatives first, then if appropriate, to use derivatives to mitigate risk. Start with risk discovery: identification of the areas of the business or investment portfolio that may be adversely impacted by movement. The first question to answer is whether foreign currency exchange rates present a material risk to the business.

Is FX material to your business?

Do you need to worry about whether FX will affect your business performance? This depends on some basic attributes which determine the materiality of the potential expense of FX.

For an extensive list of the attributes that signal a higher risk of FX materiality, please refer to this recent publication on the topic[3].

For now, here is one way to analyze FX materiality specific to your current business operations: Consider your non-US dollar expense levels for the next fiscal year or for the extent of a clinical trial – now assume the currency you are buying cost 10% more simply due to a change in the FX rate. The impact on your cash burn and runway will be felt, and value-add of going from a passive to an active FX management strategy may be well worth the effort.

FX is material to my business. What do I do now?

Is derivative-based hedging the answer? Not always. Another type of hedging, natural risk management strategies (not involving derivatives), is available and should be evaluated first for possible implementation for your business. Apply these strategies, some of which are listed below, before you consider derivatives or any other financial instrument to manage FX risk.

Using active natural risk management strategies

Natural strategies are mitigation strategies solely driven by your business operations decisions. Several of these are (by definition) hedging strategies, but they are not tied to any non-currency related financial instrument.

Some examples of active natural strategies:

- If you anticipate having to buy foreign currency for global operations, pre-fund a multi-currency account. In other words, buy your needs for multiple quarters out today and hold it until needs arise.
- Establish a liability stream in the country where you have revenues and vice versa (asset-liability matching).
- Explore the merits of raising venture funds or borrowing in foreign currencies.

These natural strategies arise from decisions that you control for your business. However, they may not be enough to reduce your possible costs to the point where you are comfortable. Nonetheless, we recommend that you exhaust all your natural remedies before turning to other types of hedging.

Active strategies, using financial instruments

After adopting these natural strategies, if your company's exposure to currency swings is still too high in the context of cash burn, the business valuation, topline revenue targets, or desired business KPIs, then other tactics may be needed to protect your bottom line.

For instance, your company can incorporate derivatives or financial instruments such as issuing non-USD denominated debt, which can further reduce the uncertainty of FX. Handled actively and strategically, active management of FX can transform an unpredictable drag on your performance into earnings, margin improvement and total returns.

[3] SVB FX Risk Advisory for Life Science and Healthcare: Is FX material to your business? June 2021.

Conclusion

Exchange rate changes are not within your span of control. Nor are they predictable with respect to any other factor, as they may move independently of any other value stream. You can't eliminate the risk of currency swings, so you should assess the potential impact and design a way to hold your exposure to a level you can live with.

Implementing an appropriate active FX management strategy into your company's financial planning and analysis (FP&A) process can help mitigate currency risk, provide more accurate reporting, and establish benchmarks against which to measure performance.

Talk to us

- SVB stands ready to help assist clients better understand and, if appropriate, manage their currency exposure and identified risk.
- SVB has a dedicated team and a robust suite of global payments and foreign exchange solutions to help LSHC clients better deal with their unique challenges.
- Your success is our goal. Contact your SVB FX Advisor, Peter Compton, Head of FX Life Sciences & Healthcare Practice at pcompton@svb.com, or Ivan Oscar Asensio, Ph.D., Head of FX Risk Advisory at iasensio@svb.com

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