

# CAPITAL LETTER

Issue #4

## Introduction

Minimizing risk is an important maxim for any business. In fact, one of the main dangers the company needs to contain emanates from the foreign exchange market fluctuation. Purchasing a set amount of foreign currency in advance through Forward Contracts is one way to avoid getting caught out.

However, the usual Forward Contract specifies the exact binding maturity date for the delivery (and receipt) of the underlying currencies. In order to better fit specific investors' considerations, a contract may be structured to allow certain flexibilities on the period of delivery, the frequency of deliveries and the amount in each delivery.

## Flexible Forward

The Flexible Forward enables the holder to adjust the delivery schedule of currency payments up to, but not beyond, a final expiration date and total notional amount. It has an "on or before maturity" date and may be executed either in whole or in part, at any time between the booking date and the maturity date of the contract. The Flexible Forward is used when a customer does not know the exact date of his commitment or if he takes out one contract for multiple transactions.

## Example

Assume a company has regular payments in EUR, but is uncertain as to when the payments will be required. To protect against the exchange currency risk while maintaining full delivery flexibility, the company enters into a Flexible Forward contract.

With a current EUR/USD rate at 1.3550, the nine-month forward rate is 1.3565 and the nine-month Flexible Forward rate is 1.3580.

Let's assume that the company books a Flexible Forward for 9 months at 1.3580 for an amount of EUR 9,000,000. If 2 months after the booking date, the company has a payment of EUR 2,000,000, it can take delivery of this amount at the booked rate and will have a remaining EUR 7,000,000 until maturity.



## Preferred Shares

### Definition:

A class of securities that have common characteristics with both debt and equity. Also referred to as preferred securities, Tier 1 securities or hybrid capital, they are perpetual subordinated instruments issued by a financial institution (or eventually a corporate) to complement its Core Capital.

### Main characteristics:

- Offer a predefined regular return
- No fixed maturity
- Callable at the option of the issuer on specific "Call Dates"
- Ability to skip payments without defaulting
- Rank behind traditional bonds in a company's capital structure
- Preference to dividends over common shares
- Usually non-voting
- Coupon payments can be cumulative or non-cumulative

## Example

### Preferred Shares compared with Bonds

Similarities	Differences
<ul style="list-style-type: none"> <li>• Periodic payments</li> <li>• No Capital appreciation</li> </ul>	<ul style="list-style-type: none"> <li>• Bonds rank higher in priority in an event of Default</li> <li>• Bonds have a fixed maturity date unlike Preferred Shares which only have Call dates</li> <li>• Payments on Preferred Shares can be skipped while a non-payment of a coupon on a Bond constitutes an event of Default</li> <li>• Preference Shares are considered as Capital while Bonds are considered as Debt</li> </ul>

### Preferred Shares compared with Common Shares

Similarities	Differences
<ul style="list-style-type: none"> <li>• Both are considered as the company's Capital</li> <li>• Dividend payments are not mandatory</li> </ul>	<ul style="list-style-type: none"> <li>• Preferred Shares rank higher in priority in an event of Default</li> <li>• Preferred Shares have priority against Common Shares in dividend payments</li> <li>• Preferred Shares have predefined dividend rate while Common Shares' dividends depend on the company's performance</li> <li>• Preferred Shares are usually non-voting while Common Shares are voting</li> </ul>

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