

FLIR SYSTEMS, INC.

ENTERPRISE FX MANAGEMENT THAT REDUCES
EXPOSURE ABOVE AND BELOW THE LINE

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Randahl Finnessy

Vice President, Corporate Treasurer
FLIR Systems, Inc.



FLIR Systems, Inc. and FiREapps

A FRESH APPROACH TO FOREIGN EXCHANGE AND CASH FLOW MANAGEMENT

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Company & Case Study Quick Facts

Industry

Infrared Systems

Annual Revenues

\$1.5 billion

Business Landscape

48 percent of revenue generated internationally

ERP Environment

SAP and IFS

FiREapps Solution

Balance sheet exposure analytics

Revenue and expense exposure analytics

CoRE Analysis

Decision optimization

Executive Summary

Under the leadership of a new treasurer with a strong FX background, FLIR’s approach to managing foreign exchange exposure and risk has undergone a dramatic transformation over the past several years. What used to be an informal and labor-intensive manual process is now a structured, automated FX management program that elevates the benefits of exposure elimination and hedging beyond treasury to the corporate level, both strategically and operationally.

The FLIR FX management program takes a holistic cost-benefit approach to minimizing FX gain/loss while protecting EPS and providing predictability in the income statement. Using FiREapps cloud-based software to identify, analyze, eliminate, and manage foreign exchange exposure and risk across multiple currency pairs, the treasury team at FLIR has:

- ➊ **Increased confidence in exposure numbers** from zero to 90 percent with automated data extraction from SAP and template-based aggregation from other systems of record.
- ➋ **Organically reduced balance sheet exposure** by more than 50 percent in the first six months by using exposure intelligence to restructure and settle outstanding intercompany transactions.
- ➌ **Instituted a successful hedging program** that reduces volatility in the income statement and enables historical cost/risk analysis to identify new currency pairs for future hedging with optimized interest income.
- ➍ **Improved cash management decision-making** by analyzing the historical impact of FX on forecasted revenues and expenses, and enabling collaboration between treasury and accounting to mitigate risks across the income statement.
- ➎ **Continuously adapted and improved the program** using a monthly Cost and Risk Efficiency (CoRE) Analysis to align FX risk management strategies with corporate risk tolerances.

CHALLENGE

VOLATILITY IN THE INCOME STATEMENT DUE TO FX SURPRISES

“*Since we were an SAP shop and the majority of FLIR’s large subsidiaries were running a single instance of SAP that updated instantaneously, I thought we would be able to identify enterprise-wide exposures fairly easily. That was not the case.*”

Randahl Finnessy



Without a formalized foreign exchange risk policy or management infrastructure in place, FLIR’s treasury team could not systematically identify or analyze the company’s global exposures, which left EPS and earnings susceptible to unpredictable FX gains/losses. This is the situation Vice President, Corporate Treasurer Randahl Finnessy faced when he joined the company in late 2008.

As a former bank FX trader, Randahl clearly understood the importance of complete, timely, and transparent exposure data when it comes to managing foreign exchange. However, at the time, FLIR’s treasury team was stuck in a quagmire of hunting down exposure data from operating units every month only to find that it was too dated and incomplete to analyze, let alone act on.

To compensate for the incomplete data, they looked at historical patterns to try to anticipate future currency movements, and then pay down or build up intercompany accounts accordingly. This pre-pay/lag technique may have been good enough in a stable economic environment with calm currency markets and predictable sales, but those conditions were long gone by the end of 2008.

In addition, while FLIR operates two autonomous but strategically interrelated operating units (Government Systems and Commercial Systems), looking at exposures only at the divisional level obscured natural hedging opportunities, where income in one currency in one division was offset by expenses in that currency in another. Identifying these exposures was key, since a natural hedge is the most cost-effective way to hedge.

“When I first arrived at FLIR, the most immediate challenge was to get my arms around the FX gain/loss being posted to the income statement by unearthing the exposures causing the volatility,” Randahl recalls. “Since we were an SAP shop and the majority of FLIR’s large subsidiaries were running a single instance of SAP that updated instantaneously, I thought we would be able to identify enterprise-wide exposures fairly easily. That was not the case.”

After spending several months working to solve the problem in house with limited IT resources, Randahl decided to look outside the company for a solution. “Trying to construct something from scratch was hard because our IT staff are expert with SAP, but they are not FX experts,” he says. “After several starts and stops, we still couldn’t get enough detail in the reports from SAP. Plus, we had field offices that were on various other ERPs, and their data wasn’t being captured at all. I decided to stop pulling IT resources from other parts of the company and look to an outside vendor for help.”

A dynamic business environment introduces FX exposure and risk

FLIR has major manufacturing operations in the U.S. and Sweden; sales and service offices in the U.S., Europe, Middle East, and Asia; and growth strategy based on a number of factors, including growth in existing markets, entrance into new markets, design and development of innovative sensor systems, reduction of operating costs, expansion of global reach, building application awareness, and complementing core competencies with strategic acquisitions — all potential exposure generators capable of causing unacceptable volatility in the income statement.

SOLUTION

ENTERPRISE FX MANAGEMENT THAT REDUCES EXPOSURE ABOVE AND BELOW THE LINE

“Because FiREapps software is delivered as a service in the cloud, I knew that it would help us stay nimble and adaptive to change without requiring IT resources on our end. And having access to FX pros outside of the company when our resources were scarce was critical.”

Randahl Finnessy

Lacking the time and resources to build an FX management system in house, Randahl chose to partner with FiREapps for both a technology solution and FX advisory services. “Even if we had built a homegrown system, the minute our environment changed or became more complex due to an acquisition, we would have run into problems,” he explains. “Because FiREapps software is delivered as a service in the cloud, I knew that it could help us stay nimble and adaptive to change without requiring IT support on our end. And having access to FX pros outside of the company when our internal resources were scarce was critical.”

The first step in the engagement was to prove that FiREapps could provide a view of total exposure based on complete and accurate monetary asset and liability data pulled from SAP. Working with Randahl and an IT resource from FLIR, FiREapps developed an SAP query in less than 30 days, which FLIR’s IT person then deployed in less than three hours. After comparing the FiREapps results against exposure data manually gathered and verified from individual accounts, FLIR confirmed that the proof-of-concept query could indeed extract the formerly elusive exposure data.

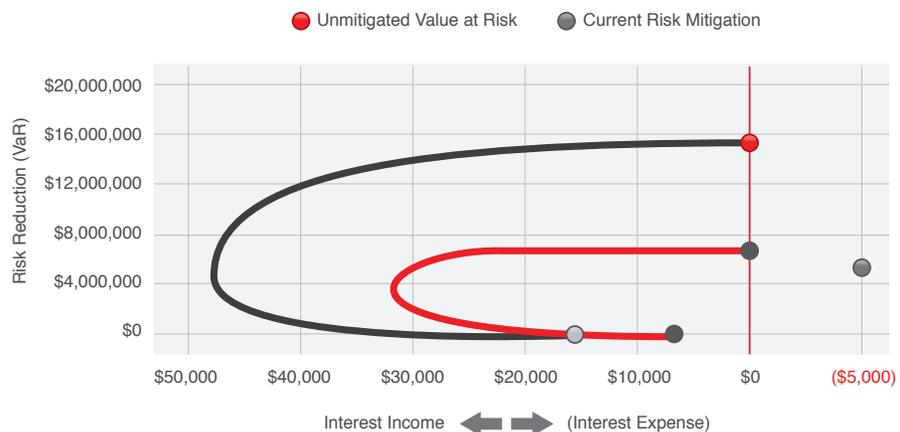
In addition to absolute exposure, the FiREapps CoRE Analysis presents risk information for all currency pairs using the results of a parametric Value at Risk (VaR) calculation of the possible foreign exchange gain or loss per quarter.

CoRE ANALYSIS - WHAT A DIFFERENCE A YEAR MAKES

Analyze exposure and the cost/benefit of managing risk

FiREapps FX experts guided FLIR through an initial Cost and Risk Efficiency (CoRE) Analysis to benchmark their hedging program actions from a cost/risk perspective with a view towards incrementally expanding their program with the right currency pairs.

The analysis identified three dozen currency pairs representing about \$97 million in gross exposure and \$16 million Value at Risk (VaR), which equated to roughly \$0.25 EPS at risk per quarter. The analysis also revealed that treasury could potentially gain over \$40,000 in quarterly interest income with a 70 percent risk reduction by taking advantage of forward hedge rate discounts.



After using FiREapps for one year, more effective exposure management reduced VaR by over 50 percent while maintaining the opportunity to generate over \$20,000 in quarterly interest income with minimal risk.

A COST-BENEFIT APPROACH

“ *There’s nothing worse than blindly entering into contracts without understanding your exposure — you will inevitably compound the problem, and it will not end well. Understanding our exposures and their magnitude tells us when, where, and how to attack volatility.*

Randahl Finnessy



With a clean slate to work from, FLIR opted to pursue a cost-benefit approach that takes into consideration not just nominal exposure, but also the underlying risk posed by the volatility of each currency pair as identified in the FiREapps CoRE Analysis. “Even though most risk lies in non-G10 emerging market currencies, the temptation was to manage only our largest and most visible pairs, such as the dollar/Swedish kronor,” Randahl explains. “When we looked at things from an overall risk perspective, it changed our thinking in terms of the policy we were crafting and the currencies we wanted to hedge.”

Today, FX management at FLIR has evolved into a robust, formalized program built on a solid understanding of FX exposure, the volatility of each currency pair, and overall risk. The FiREapps solution insulates the income statement from currency volatility below the line with analytics to find, reduce, and mitigate exposure in the balance sheet, and above the line with historical analytics to understand the impact of exposure on forecasted revenues and expenses and make informed decisions to reduce risk in future periods.

Identifying and analyzing exposure

FiREapps extracts data from SAP and other systems of record on demand, and enables Randahl to generate a report on exposures by currency pair, as well as at the corporate level, in 15 minutes or less. He reviews exposures weekly and, armed with this information, is well equipped to go to the markets to offset them. “There’s nothing worse than blindly entering into contracts without understanding what is going on at that moment in time — you will inevitably compound the problem, and it will not end well,” he says. “Understanding our exposures and their magnitude tells us when, where, and how to attack volatility.”

Reducing exposure organically

“FiREapps analytics and reports provide a single truth for understanding exposures at the account and entity levels, enabling corporate treasury to work with regional controllers to investigate the root causes of exposures, improve processes, and mitigate risk across geographies and divisions,” Randahl notes.

The FiREapps software recommends specific actions including cash conversions, intercompany settlements, and natural hedges based on FLIR’s specific risk tolerance and policy parameters. Because Randahl knows he can trust the numbers FiREapps uses to make recommendations, he has the confidence to act on them on an operational level. “Recently, we were able to direct one of our subsidiaries to pay down intercompany balances because we saw that they had enough foreign currency to offset them,” he says. “Without having FiREapps to put cash, A/R, A/P, and other items into one view for us, we would have had to go into SAP, run a balance sheet for that subsidiary for that currency, look at what was in their bank account, and identify the potential offsets to determine if they could actually pay off the intercompany debt. In other words, they would probably still be sitting on the cash.”

A COST-BENEFIT APPROACH

“ Over the course of the next six months, we saw a tremendous dampening of the volatility in the income statement just from hedging that one currency pair alone.

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Managing exposure through hedging

Within six months of deploying the software, FLIR started hedging the dollar/Swedish kronor pair based on FiREapps recommendations and began forecasting out a month at a time. “Over the course of the next six months, we saw a tremendous dampening of the volatility in the income statement just from hedging that one currency pair alone,” Randahl says. Treasury now regularly hedges 5 to 10 currency pairs for additional FX stability and predictability.

FiREapps enables FLIR to evaluate hedges under three scenarios:

- 🔴 **Reduce exposure** — FLIR leverages FiREapps CoRE analytics to recommend hedges that present the least cost / greatest income based on the total exposure by currency pair.
- 🔴 **Reduce risk** — FiREapps Value at Risk (VaR) analytics help FLIR manage currency pairs to minimize FX gains and losses.
- 🔴 **Optimize interest income** — CoRE analytics enable FLIR to benchmark past hedging program actions from a cost/risk perspective, and identify additional currency pairs with the best potential to optimize interest income in the future.

FiREapps also provides the analytics and intelligence required to actively review and modify the risk policy as appropriate.

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Analyzing exposure for improved forecasting and cash management

The VaR analysis provided each month by FiREapps piqued the interest of FLIR CFO Tony Trunzo, because he saw its potential application beyond treasury; namely, to help finance improve forecasting and make more informed cash management decisions. To test the theory, FLIR deployed additional FiREapps functionality to learn how FX was impacting revenues and expenses. For example, if the Swedish kronor was lower in a particular quarter and therefore Swedish operational costs were down, why weren't net incomes higher? Or, if revenues were in dollars and euros and those currencies were favorable for the month, why didn't that translate to better margins?

“A classic response when expenses were too high or margins were too low was, ‘It’s a currency issue’,” Randahl recalls. “With FiREapps, we can see our revenues and expenses by currency. This allows us to get to the bottom of things by looking into the components that make up gross margins.”

This new level of information and analysis has created a strong demand across the company to align revenue and expense analytics with the management reporting that accounting needs. Randahl fields numerous requests from country controllers after month-end, and also provides analysis that is used at the CFO level to validate accounting results (including FX gain/loss), improve how the company handles translation, and report quarterly to the Board on where currency risk is being evidenced (manufacturing sites show it in payables in local currency, for example) and what is being done to manage the underlying exposure. Because FLIR is a growth and earnings-driving company, the analysis also provides the ideal framework for educating the executive team and investment community.

RESULTS

AN INSURANCE POLICY AGAINST EXPOSURE, VOLATILITY, AND RISK

“ *At any point in time, do we know what 90 percent of our worldwide exposure is on a currency-pair basis? Yes, we do. And, because we trust the validity of the data, we're very confident in that number.*

Randahl Finnessy



FLIR's innovative use of FiREapps — not only as an FX tool, but also as a decision-support framework for improving forecasting and cash management — is now part of the regular finance routine. Volatility in the income statement remains predictable and low, and, according to Randahl, all stakeholders are believers in the program. “Using this new bit of essential plumbing, we've proven over time that we know what we're doing in the day-to-day business. It has become part of the culture, and everyone is confident that the way we're looking at exposures and dealing with local offices is working,” he says. “As with most things in risk management, a non-event is a good thing.”

Broader and deeper visibility into foreign currency exposure data

Before FiREapps, Randahl and his team had little confidence in their exposure numbers because the only way they could get visibility into each company's exposure was by going into individual company accounts and seeing what the transactions were per currency. “It was tedious, laborious, and extremely painful,” he says. “With FiREapps, we're pulling actual exposure data, which gives us tremendous credibility within the company and throughout the reporting structure. At any point in time, do we know what 90 percent of our worldwide exposure is on a currency-pair basis? Yes, we do. And, because we trust the validity of the data, we're very confident in that number.”

Timely access to new exposure information when the FX landscape changes

Unlike an on-premise solution, the cloud-based FiREapps platform gives FLIR the flexibility and scalability required to keep pace with a dynamic business environment that is constantly changing due to rapid growth, acquisitions, shifts in strategy, and unpredictable market conditions.

For example, when FLIR purchased a company that had major FX exposure in a non-SAP system, FiREapps developed an extract and, within a couple weeks, the new exposures were being combined with existing exposures for a corporate-level view. “If we didn't have FiREapps pulling all of the data together, we would have needed another set of IT people,” Randahl says. “Let me tell you, during acquisition integration, getting IT staff to focus on FX data is difficult. All the while, you know you have all kinds of inherited exposure, but no way to identify it or understand how it is impacting the corporate net position. They might be hedging the opposite side of what you're doing, which means you're creating your own volatility in the income statement.

“In my opinion, if you are a multinational in acquisition mode or you do regular integration of disparate accounting systems, you definitely need FiREapps.”



RESULTS

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Randahl Finnessy
Vice President & Corporate Treasurer
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Analytics and expert support for better decisions that reduce risk and cost

The combination of FiREapps software and expert support provides the tools and the knowledge Randahl needs to successfully protect FLIR. “The software actually does what it purports to do, which means I have the understanding I need to make the best hedging decisions possible and to work with the subsidiaries and controllers to troubleshoot FX issues by currency pair,” he says. “And the people behind the product are truly there to support me. If I pick up the phone and ask a question I've asked three times already, or want to know how to do a specialized analysis for my CFO, I know they're going to help me.”

No surprises

The FLIR FX management program minimizes FX gain/loss to protect EPS and provide predictability in the income statement. According to Randahl, “Foreign exchange risk has a way of punishing you regularly. To be able to buy an insurance policy against exposure — which is how I view our FiREapps license — is phenomenal. When you consider how much extreme volatility could cost you in a single month, it's a ridiculously small price to pay — and it has paid for itself many times over.”

To learn more, visit us at www.fireapps.com