AMERICAN DEPOSITARY RECEIPTS

Richard Ivey School of Business
The University of Western Ontario

Definition: ADRs

- American Depositary Receipts (ADRs) are dollar-denominated negotiable securities representing a share of a non-US company.

- This security trades and settles in the US like all other US securities.

- Allows non-US companies to have their stock traded in the US. It reduces the settlement delay, transaction costs and other inconveniences associated with international securities trading.

- ADRs are issued when a US depositary institution buys shares of a foreign company.

How is Trading Performed With ADRs

- The Depositary Receipt is issued by a US depositary bank upon purchase of the underlying, foreign shares. These certificates can then be bought and sold in the US.
- When the holder of the DR sells, it can be either sold to another investor or it can be cancelled and the underlying shares released back into the home market (flowback).
- The holder of the DR can also request the actual share(s).
- The depositary bank is responsible for paying dividends and voting the shares at the annual meetings.

Types of ADRs

- Two types of ADR’s:
  - ***Sponsored ADR’s*** – the firm approaches a depositary bank to manage their shares in the US. They have to provide different amounts of information to investors based on the type of ADR.
  - ***Unsponsored ADR’s*** – the non-US shares are offered to US investors without the firm’s active participation
- Usually pre-existing shares that are held at the depositary bank and the ADR trades as its “proxy” on the US exchange.
- Some firms issue new shares in their ADR programme (Note: this requires a special type of ADR programme)

Unsponsored ADRs

- Unsponsored ADR:
  - Depositary receipts are issued because brokers have found a demand by US investors for the non-US firm's stock.
  - The depositary institution buys the stock on the local exchange for its customers and gives them an ADR as a proxy for the share that it holds outside the US.
  - These trade over the counter and have little regulation other than registering that it is being traded in the US with the SEC and providing investors with copies of its home market financial statements.
  - Trades as a Level I ADR.

Types of Sponsored ADRs

- Level 1: the simplest and least expensive. The certificates are traded over the counter. There is minimal regulation and disclosure (only what was required in the home market).

- Level 2: this level is required for the receipts to trade on an exchange. The financial statements must partially comply with US GAAP (annual reports) and must be registered with the SEC.

- Level 3: this level requires the firm to file detailed current financial statements conforming to US GAAP (annual and quarterly reports). This level is required to raise new capital in the US (e.g. to sell receipts for new shares in the US).

Raising Capital Through ADRs?

– Rule 144A or Private Placements:
  - the ADR can be Level 1 or 2.
  - Companies can issue new equity *only with qualified institutional buyers* (QIBs) in the US. After issue these shares can only be traded among these buyers.

– Level 3:
  - This requires filing of detailed current financial statements conforming to US GAAP.
  - As a result of this detailed disclosure, the new shares can be sold to all investors and the investors can trade with each other on the listing exchange.

Comparison of Types of ADR

Type	Degree of Disclosure	Listing Alternatives	Ability to Raise Capital
Level I	None	OTC	Must upgrade / 144A
Level II	Detailed	Exchange	Must upgrade / 144A
Level III	Rigorous	Exchange	Yes
Private DRs	Euro-style	QIBs	Yes

SEC Registration vs Rule 144A

	SEC Registered	Rule 144A
Pros	◆ Broad distribution (adds retail) ◆ Heightens visibility ◆ Enhances liquidity (no restriction on transfer) ◆ Facilitates future issuance ◆ US employee stock option ◆ Acquisition currency	◆ Speed of execution ◆ Ability to access key US investors (QIBS) ◆ Inexpensive access (time/cost) ◆ No SEC review process ◆ No US GAAP reconciliation ◆ No reporting requirements
	US generated demand *25 - 40% of total demand*	2-3x> *US generated demand* *5 - 15% of total demand*
Cons	◆ Time consuming and costly ◆ Financial disclosure, conformity to US GAAP ◆ Ongoing disclosure requirement ◆ Not always necessary for successful offering	◆ Potential valuation discount ◆ Reduced incremental demand, no retail participation ◆ Limitation on size of offering ◆ Restricted liquidity

Value of Types of ADR Programme