AMERICAN DEPOSITARY RECEIPTS

Definition: ADRs

- American Depositary Receipts (ADRs) are dollar-denominated negotiable securities representing a share of a non-US company.
- These securities trade and settle in the US like other US securities.
  - Allows non-US companies to have their stock traded in the US and reduces the settlement delay, transaction costs and other inconveniences frequently associated with the trading of international securities.
- ADRs are issued after a US depositary institution buys shares of a foreign company.

Trading With ADRs

- A US depositary bank purchases foreign shares. For each share, or group of shares, a depositary receipt (DR) is issued. These certificates can be bought and sold in the US.

- When the holder of the DR sells, the Receipt can either be sold to another investor or it can be sold back to the depositary bank which will likely cancel the Receipt and sell the underlying share in the home market (flowback).

- The holder of the DR can also request the actual share(s).

- The depositary bank is responsible for forwarding financial statements, paying dividends and voting the shares at the annual meetings.

Types of ADRs

- Two major types of ADR’s:
  - ***Sponsored ADR’s*** – the firm approaches a depositary bank to manage their shares in the US. These firms have confirmed they want to have their shares traded in the US. They have to provide different amounts of information to investors based on the type (or level) of ADR.

  - ***Unsponsored ADR’s*** – the shares of non-US based companies are offered to US investors without the firm’s active participation. The firms have not requested to have this service provided to US-based investors.

Unsponsored ADRs

- Depositary receipts created and 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 the investors an ADR as a proxy for the share that it holds outside the US.
- The proxies trade over the counter. There is little regulation other than the depositary institution registering with the SEC that the shares are being traded in the US. The depositary bank must provide investors with copies of the firm's *home* market financial statements.
- Trades as a Level 1 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).   Filing information is similar to what a publicly listed US firm would have to disclose.

Raising Capital Through ADRs?

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

- 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 / Level III

Pros

- Broad distribution (adds retail)
- Heightens visibility
- Enhances liquidity (no restriction on transfer)
- Facilitates future issuance
- US employee stock option
- Acquisition currency

US generated demand
25 - 40% of total demand

2-3x>

Cons

- Time consuming and costly
- Financial disclosure, conformity to US GAAP
- Ongoing disclosure requirement
- Not always necessary for successful offering

Rule 144A

Pros

- 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
5 - 15% of total demand

Cons

- Potential valuation discount
- Reduced incremental demand, no retail participation
- Limitation on size of offering
- Restricted liquidity

Value of ADR Programmes