

American Depositary Receipt (ADR)

A sponsored American Depositary Receipt (ADR) is a mechanism to convert the existing equity shares listed in India, into ADR for trading in US market. This mechanism allows the shareholders in India to convert and sell their equity shares in US market and realise the proceeds net of issue expenses. In December 2002, RBI allowed Indian companies to offer their domestic investors, an option of converting their domestic share into ADRs that is listed on the LSE, LxSE, and NYSE etc.

Three factors are important to a Sponsored ADR mainly: -

1. ADRs do not lead to any additional issue of equity shares by the company. Number of available shares for trading in Indian market comes down and of ADR enlarges in total proportion. A sponsored ADR, infuses liquidity in overseas market.
2. No money is accrued to the company. The company does not issue new shares and tend to benefit notionally as the base is extended in the hand of large institutional investors.
3. This reduces arbitrage opportunity. The offer gives Indian investors a chance to book premium in the international market, as there might be a high demand of Indian ADRs.

Pursuant to the RBI regulations, an issuer in India may sponsor the issue of ADRs through an overseas depository against underlying equity shares accepted from holders in India. The guidelines lay the conditions, such as: -

- i. Prior approval of Foreign Investment Promotion Board (FIPB) is required for a sponsored ADR offering;
- ii. ADRs is offered at a price determined by the lead manager of the Offering;
- iii. All equity holders may participate;
- iv. Issuer should obtain shareholders' approval; and
- v. Proceeds should be repatriated to India, within one month of the closure of the issue.

Such issues of ADR/GDRs come under the purview of SEBI takeover code if these are cancelled and underlying shares are registered with the company as shareholders. Divestment can be initiated by entities whose share are being offered in foreign markets against the block of existing shares, under provisions of the norms set by RBI. Sponsoring company will have to give an option to all shareholders indicating amount of shares to be divested and inform them of the price determination mechanism. If shares offered for divestments, are more than the pre-specified numbers, additional shares shall be accepted for divestment in proportion of existing holdings. Proposal for divestment of the existing shares in the ADR/GDRs market will have to be approved by a special resolution of the company. ADR/GDRs issue may be kept in an ESCROW account created for the purpose, and in any case, the retention of shares in such account should not exceed three months.



Infosys was the First Indian Company to take advantage of the changed procedure and abled to offer more shares to its overseas investors without actually issuing fresh shares. ADR offer is an off-market transaction, not put through a recognized stock exchange in India, so it attract capital gains tax in the hands of all shareholders. All shareholders who have held the Infosys shares for over 12 months will have to shell out a long-term capital gains tax of 10% (plus applicable surcharge). Shareholders who have held it for less than 12 months will have to pay a short-term capital gains tax at the maximum marginal rate (up to 30%, depending on the tax bracket they fall in).

Investors are eligible on a pro-rata basis depending on their holding in the company. This means that higher the number of shares individual investor own, the more chances for his shares getting accepted in the offer.

Companies do not issue new shares. Thus, the offer does not lead to any dilution of equity and earnings per share (EPS). They are making this offer to satisfy the demand for ADR traded in US markets. This allows companies to have new investors and create visibility on the US stock exchanges. They also satisfy the local investor by offering an opportunity to sell their shares at a higher price than available locally on the Indian bourses.

In effect, it is not the company, which is actually selling the shares to the foreigners but the shareholders themselves. There is no increase in the share capital of the company but the shares are transferred between two categories of investors. Benefit is that the liquidity in the foreign market is increased. Move is beneficial for the Indian investors when the quotation on the foreign bourses is at a premium to the local traded price and shareholders get a higher value for the shares sold. The entire process of ADR Issue, takes around three months and steps may be as by the flow chart



Flow Chart

On a board decision for the ADR Offerings, company seeks the approval of the shareholders, and of Foreign Investment Promotion Board (FIPB);



A Lead Manager to the Issue is Appointed;



An Offer Document with US SEC is filed to seek regulatory approvals. Full review of the process takes 4-5 weeks. Already listed companies, on the NASDAQ is not required to have the offer document authenticated by the exchange and takes one week for The Offer Document is made to public followed by Road Shows.



An ESCROW account is created by the lead manager and makes an open offer to Indian shareholders to tender their shares. If the number of shares offered for conversion is more than the offered number. Conversion takes place on a pro-rata basis.



Book-building process is followed to offer the ADRs to Overseas Investors.



Prevailing market price of the issuing company on the NASDAQ/NYSE, determine the price of the issue by the Underwriters. During the process, if issuers scrip rises further on NASDAQ, total issue amount also increases.



All shareholders, holding underlying Indian equity shares, have a pari-passu (equal) right to tender their shares.



On completing book-building process, lead manager brings back the money to India with in a month of the issue. Proceeds of secondary offerings, on meeting the Issue Expenses, are proportionately paid to the shareholders of company who had submitted their equity shares.



Shareholders have to bear the expenses for the conversion into ADR. They bear the procedural costs, which could be only in the range of 5-7% (as per RBI regulation), depending upon the number of shares and issue size.

