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ADRs/ GDRs

11.1 Meaning

Indian Companies can raise foreign currency funds from abroad in the following ways:

(a) by the issue of ADRs/ GDRS (dealt with in this Chapter)
(b) by the issue of ECBs (dealt with in Chapter 12)
(c) by the issue of FCCBs (dealt with in Chapter 12).

ADRs/ GDRs are one segment of capital instruments of which one hears and reads about a great deal. Several Indian corporates have issued or have lined up plans to issue ADRs/ GDRs. According to the RBI, in 2004-05 Indian companies raised $613 million via ADRs/ GDRs. As compared to this the figure in the period from April – January 2006 was $2,141 million. This shows that an increasing number of Indian companies are eager to tap the foreign equity markets. Let us examine what these instruments are and how do they operate. An ADR means an American Depository Receipt, whereas a GDR means a Global Depository Receipt. ADRs (also known as American Depository Shares or ADS) are listed on an American stock exchange. The entire issue process is in accordance with the rules and regulations laid down by the Securities and Exchange Commission or SEC (the capital markets regulator in the USA). Compared to ADRs, GDRs are listed on a stock exchange outside the USA, normally on the Luxembourg or London stock exchange. However, nowadays several companies are even listing on newer exchanges such as Singapore, etc. ADRs/ GDRs allow companies to tap foreign investors and thereby have a wider shareholding leading to better valuations and stakeholder value creation. Companies prefer the GDR route compared to an ADR because the disclosure, accounting and compliance requirements in the USA are far more stringent and onerous as compared to those in the case of a GDR issue, say in Luxembourg. But several well managed companies, such as Infosys, HDFC Bank, etc., prefer the ADR route. Since the USA is the world's single largest capital market, it goes without saying that viewed from an investment perspective it makes more sense to list in the USA. However, concerns of compliance and costs also prevail.

11.2 Reason

Indian companies are prohibited from directly issuing rupee denominated securities which can be listed abroad on foreign stock exchanges. Thus, the equity shares of an Indian company cannot be directly listed on, say, the New York Stock Exchange. To overcome this problem, Indian companies adopt the ADR/ GDR route.

11.3 Instrument

An ADR is quoted in US dollars and one ADR represents a certain number of equity shares in the Indian company. The foreign investors can then directly buy and sell the ADRs as if they were the shares of a foreign corporation. If the investor wants he can convert the ADR into the equivalent number of underlying equity shares. The ADR would then be cancelled as it would be converted into the equity shares.

11.4 Process

The broad commercial steps involved in an ADR issue (for the sake of simplicity we shall only look at an ADR issue as the GDR issue is more or less similar) is as follows:

(a) The Indian company would issue rupee-denominated equity shares to a depository based in America.

(b) A custodian in India would keep these shares in its custody.

(c) The depository would issue dollar-denominated receipts or shares to foreign investors, known as ADRs/ ADSs. It would also set the ratio between the ADRs and the equity shares, i.e.,one ADR is equal to how many equity shares. It could be one, more or less than one equity share. It all depends upon the pricing of the share in the Indian market. The objective is to so price the ADR that it does not become very expensive and out of reach for the retail foreign investors.

(d) A public issue would be made of the ADRs in USA and elsewhere. The investment bankers would organise road shows and try and market the issue to institutional and retail foreign investors. The book building method is used for the issue.

(e) The ADRs would be listed on a US stock exchange, e.g., Nasdaq or New Stock Exchange.

(f) Foreign exchange fluctuation risk or gain is to the account of the foreign investors.

(g) For the company there is no burden of repayment or interest.

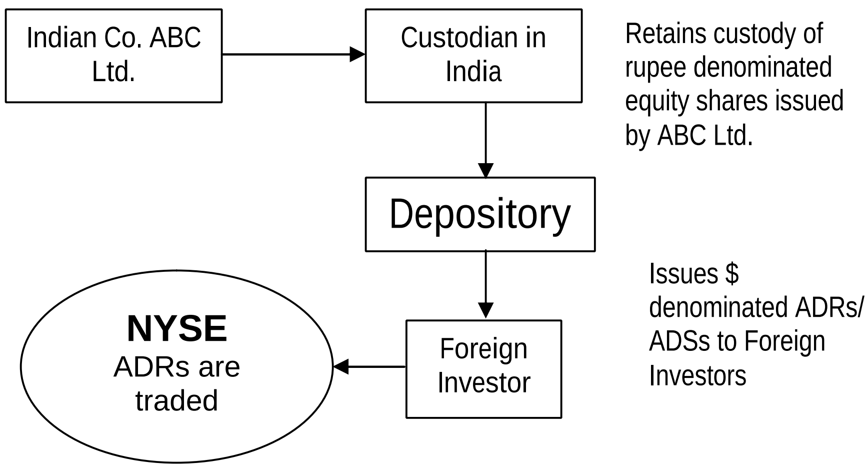
(h) The company would pay dividend to the depository in rupee terms but the depository would distribute this dividend to the ADR holders in dollars.

(i) For the investors their point of contact would be the depository.

(j) The Indian company would need to comply with the SEC requirements in terms of compliance and accounting norms, such as US GAAP.

(k) The ADR holders may exercise their right to vote through the overseas depository bank.

The flow of transactions is illustrated by the following chart:



11.5 Two-way Fungibility

The two-way fungibility in ADRs/ GDRs has spruced up the ADR/ GDR market. Two-way fungibility was introduced by the RBI in 2001. Earlier, the ADRs/ GDRs could be converted into ordinary Indian shares by the foreign investors however, the converse was not possible. Now a registered broker can purchase shares of an Indian company which has issued ADRs/ GDRs, on behalf of a non-resident, for converting the shares purchased into ADRs/ GDRs. The shares have to be purchased on a stock exchange only. Thus, if there is an Indian company which is only listed abroad, then it cannot avail of this facility, e.g., Satyam Infoway, Rediff, etc. The regulatory framework for the same is explained in para 11.7.2.

11.6 Sponsored ADR Programmes

Several companies are now going in for a Sponsored ADR Programme rather than a fresh issue. The company can sponsor an ADR against the existing shares held by its shareholders at a price that may be arrived at by the Lead Book Running Managers.

If a company sponsors an ADR programme, then even Indian investors can convert their rupee-denominated equity shares into ADRs/ GDRs of the company. Such a programme is known as a Sponsored ADR programme. Once the pricing of the ADRs are determined the shares tendered by the local investors would be delivered to the custodian and in return for the same, the depository would issue ADRs to foreign investors. The purchase price paid by the foreign investors to the local investors net of expenses, would be the sales consideration for the local investors. Companies such as Infosys, Satyam, etc., have successfully launched Sponsored ADR programmes. The regulatory framework for the same is explained in para 11.7.3.

11.7 Regulatory framework

11.7.1 Regular Issue

An issue of ADRs/ GDRs is governed by the FEMA Regulations as well as the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 ("Scheme") issued by the Central Government. This Scheme is the main legislation which governs the issue of ADRs/ GDRs. The important steps and conditions involved are as follows:

(a) If the company is eligible under the Scheme to float an issue then it does not require the prior permission of the Finance Ministry.

(b) The company is not ineligible to issue shares to foreign investors under the FDI policy since ADR/ GDR are treated as part of FDI.

(c) Now companies do not require the prior approval of the Finance Ministry as it has been put on an automatic route. Private placement of ADRs/ GDRs are also put on this route. RBI has also allowed such issues on an automatic route.

(d) An Indian company which is restrained from accessing the securities market by the SEBI is not eligible to float an ADR / GDR issue.

(e) Issue pricing norms, which till September, 2005 were free, have now been laid down. The minimum price in case of a listed company must be the higher of the following two averages:

- Average weekly high and low of the closing prices of the share quoted on the stock exchange during the 6 months preceding the relevant date;
- Average weekly high and low of the closing prices of the share quoted on the stock exchange during the 2 weeks preceding the relevant date;

The relevant date for this purpose means a date 30 days prior to the date on which a shareholders' meeting is called for passing a Special Resolution u/s. 81(1A) of the Companies Act, 1956. Thus, now the pricing of ADRs/ GDRs has been put on par with the preferential issue pricing norms.

(f) In case an unlisted company wishes to float an ADR/ GDR issue, then it must also take steps for prior or simultaneous listing in India.

(g) Existing Indian unlisted companies which have already issued ADRs/ GDRs must get listed in India on the earlier of their making a profit from the financial year beginning 2005-06 or within 3 years from the date of issue of the ADRs/

GDRs. This provision would impact unlisted companies such as Rediff, Satyam Infoway, etc.

(h) Existing Indian unlisted companies which have taken verifiable effective steps prior to 31st August, 2005 for getting listed are exempt from the pricing requirements (specified in (e) above) and the simultaneous listing condition (specified in (f) above). The term "effective steps" is defined to mean the following:
   (i) The company has completed the due diligence and filed the offering circular in the overseas exchange; or
   (ii) The approval of the overseas exchange has been obtained; or
   (iii) The approval of the RBI (if applicable) has been obtained for meeting issue related expenses.

(i) In addition to the exemption provided under (h) above, the Government has extended another exemption to existing Indian unlisted companies from the pricing requirements (specified in (e) above). This exemption is available to companies going in for an offering in the domestic market and a simultaneous/ immediate follow on offering (within 30 days of the domestic issue) through ADR/ GDR issues if the ADR/ GDR issues are priced at or above the domestic price. The condition is that such companies have to take SEBI's prior approval for the issue which will specify the percentage to be offered in the domestic and ADR/ GDR markets.

(j) The proceeds of the issue cannot be used for investing in the stock market or in real estate.

(k) The company can pending the deployment of the proceeds retain the proceeds abroad for investing in various short-term investments.

(l) The issue related expenses (covering both fixed expenses like underwriting commissions, lead managers charges, legal expenses and reimbursable expenses) for public issue shall be subject to a ceiling of 4% in the case of GDRs and 7% in the case of ADRs and 2% in case of private placements of ADRs/ GDRs. Issue expenses beyond the ceiling would need the approval of RBI.

(m) The company must comply with certain reporting requirements with the RBI.

11.7.2 Two-way Fungibility

The important steps and conditions involved are as follows:

(a) The Indian company must have issued ADRs/ GDRs

(b) Its shares must also be listed on an Indian stock exchange.

(c) A registered broker must purchase the shares on behalf of a person resident outside India, for conversion into ADRs/ GDRs. The buyer could be an FII/NRI/Foreign Company, etc.

(d) The shares are purchased with the prior permission of the Custodian and are then deposited with it. The Custodian would monitor the re-issuance and would ensure that the sectoral caps are not breached.

(e) The shares purchased cannot exceed the ADRs/ GDRs converted into underlying shares.

(f) The provisions of the Scheme must be complied with

(g) The maximum limit up to which re-issuance of ADRs/ GDRs can take place is to the extent of the ADR/GDR which have been redeemed into underlying equity shares and sold in the domestic market.

(h) Before executing any transaction, the broker must check with the Custodian whether there is any Head room available. Head room = Number of original ADRs/ GDRs issued (-) ADR/ GDR currently outstanding after adjusting those ADR/ GDR which have been redeemed into underlying equity shares in favour of non-resident investors. For instance the original size was 20 million ADRs and the number of cancellations which took place (because of conversion of ADRs into equity shares) is 5 million, then the Head Room in this case is 15 million.

(i) The broker would under an agreement place the domestic shares with the custodian which in turn would advise the depository of the same.

(j) The depository would issue fresh ADRs/ GDRs in lieu of the shares.

(k) Various procedural conditions are imposed.

11.7.3 Sponsored ADRs

An Indian company may sponsor an ADR/ GDR with an overseas depository against the shares of its domestic shareholders at a fixed price. The main features of the RBI guidelines in this respect are as follows:

(i) A Sponsored ADR/ GDR issue is allowed in respect of:

  (a) Divestment by shareholders of their holdings of Indian companies listed in India;

  (b) Divestment by shareholders of their holdings of Indian companies not listed in India but which are listed overseas.

(ii) The process of divestment should be initiated by the Indian companies whose shares are being offered for divestment in the overseas market by sponsoring ADR/ GDR issues against the block of existing shares offered by the shareholders.

(iii) This facility is available pari-passu to all categories of shareholders.

(iv) The sponsoring company, whose shareholders propose to divest existing shares in the overseas market through issue of ADRs/ GDRs will give an option to all its shareholders indicating the number of shares to be divested and the mechanism how the price will be determined under the ADR/ GDR norms. If the shares offered for divestment are more than the pre-specified number to be divested, shares would be accepted for divestment in proportion to existing holdings. Thus, it is not mandatory for shareholders to offer their shares.

(v) The proposal for divestment of the existing shares in the ADR/ GDR market requires a special resolution of the company.

(vi) The proceeds of the ADR/ GDR issue raised abroad must be repatriated into India within a period of one month of the closure of the issue.

(vii) Such ADR/ GDR issues against existing shares arising out of the divestment would also come within the purview of the SEBI Takeover Regulations if the ADRs/ GDRs are cancelled and the underlying shares are to be registered with the company as shareholders.

(viii) Divestment of existing shares of Indian companies in the overseas markets for the issue of ADRs/ GDRs would be reckoned as FDI.

(ix) Such divestment inducting foreign equity would have to comply with the FDI sectoral policy and the prescribed sectoral cap as applicable. Accordingly the facility would not be available where the company whose shares are to be divested is engaged in an activity where FDI is not permitted.

(x) Each case would require the approval of FIPB for foreign equity induction through offer of existing shares under the ADR/ GDR route.

(xi) The issue related expenses (covering both fixed expenses like underwriting commissions, lead managers charges, legal expenses and reimbursable expenses) for public issue shall be subject to a ceiling of 4% in the case of GDRs and 7% in the case of ADRs and 2% in case of private placements of ADRs/ GDRs. Issue expenses beyond the ceiling would need the approval of RBI. The issue expenses shall be passed onto the shareholders participating in the sponsored issue on a pro-rata basis.

(xii) The shares earmarked for the sponsored ADR/GDR issue may be kept in an escrow account created for this purpose and in any case, the retention of shares in such escrow account shall not exceed 3 months.

(xiii) If the issues of ADR/ GDR are made in more than one tranche, then each tranche would have to be treated as a separate transaction.

11.8 Takeover Regulations

The SEBI Takeover Regulations (see Chapter 18) do not apply to an acquisition of ADRs/ GDRs till such time as they are converted into equity shares carrying voting rights. Under the Takeover Regulations, the Public Announcement must be made within 4 working days before the acquisition of voting rights on securities upon conversion.