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- **ADR is a stock that trades in stock exchanges in the United States. It is a dollar denominated form of equity ownership in a non-US company.**
- **Each ADR represents a specific number of shares (one or more) in a foreign corporation**
- **ADRs pay dividends in US dollars**
- **ADRs are traded on NYSE, NASDAQ and AMEX in the United States**
- **ADRS were introduced in the financial markets in 1927**

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How did ADRs start?

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- **Due to complexities involved in buying shares in foreign countries**
- **These complexities involved trading at different prices and differing currency values**
- **So, US banks (acting as depositories) simply purchase a bulk lot of shares from the foreign company**
- **This bulk lot is then bundled into groups and re-issued on NYSE, NASDAQ and AMEX.**

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- **In return, the foreign company provides detailed financial information to the sponsor or depository bank**
- **The depository bank sets the ratio of ADRs per actual share of the foreign company.**

  For Example: 10 shares of the foreign company may be equal to 1 ADR.

  So ratio is pegged at 10:1
- **The ratio, typically called 'ADR Ratio' could be less than or greater than 1**
- **This ratio is set in such a way that an ADR's price is high enough to show substantial value, yet low enough to make it affordable for individual investors**

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An example…

- Most investors avoid investing in penny stocks or stocks trading at very low valuations; so…
- Say…a company share is trading at 50 Russian rubles per share, which is equivalent to US$ 1.50 per share
- This low price in US dollars may not reflect the company's real valuation in the United States. It may appear like a low performing stock
- That is why, majority of ADRs range between $10 and $100 per share
- Thus, if in the home country - say Russia - the share value is considerably less, then each ADR would be accordingly structured to include more shares. This is to make the price of each ADR attractive to buyers

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How are ADRs priced?

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- Let us assume that Russian Vodka Ltd, trades on a Russian stock exchange at 127 Russian rubles
- This is equivalent to US$4.58 – assume this for simplicity
- Now, a US bank purchases 30 million shares of Russian Vodka Ltd. and re-issues them in the US at a ratio of 10:1
- This means that each ADR you purchase is worth 10 shares on the Russian stock exchange

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- **A quick calculation tells us that each ADR should have an issue price of US$45.80 (US$4.58 per share X 10 shares) – since 10 shares equal 1 ADR**
- **Once an ADR is priced and sold, its subsequent price is determined by supply and demand factors, like any ordinary share**

Types of ADRs…

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- **Level 1 – This is the most basic ADR which is not normally listed on any US stock exchange. They are traded on the OTC (over-the-counter) market in the US. It is typically used as an indicator by foreign companies to determine interest levels for its stock in North America**

- **Level 2 - This type of ADR is listed on a US stock exchange. They are subjected to stricter compliance, than Level 1 ADRs, with regulations of Securities Exchange Commission, which is a securities market regulator in the United States**

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- **Level 3 - This is the most prestigious of the three types of ADRs. An ADR is considered Level 3, when the issuer floats a public offering of ADRs on a US Stock Exchange. Level 3 ADRs are able to raise capital and enjoy substantial visibility in the US financial markets**

Advantages of ADRs…

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- **Cost-effective - ADRs are an easy and cost-effective way to buy shares in a foreign company. They save money by reducing administration costs and avoiding foreign taxes on each transaction**
- **Diversification - Investor gains the potential to capitalize on emerging economies by investing in different countries**
- **More US exposure – Foreign entities favour ADRs because they get more US exposure, allowing them to tap into the wealthy North American equity markets**

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Risks from ADRs…

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- **Political Risk – Investors in ADRs need to ask themselves if the government of the home country (Russia, in previous example) is stable**
- **Exchange Rate Risk – Stability of the home country's currency (Russian rubles) needs to be assessed as well. If the Russian ruble gets devalued, the effects will be felt on the price of the ADR held by an investor. This can result in a big loss even if the company is doing well.**
- **Inflationary Risk – Currency of a country with high inflation becomes less and less valuable each day. This can be a big blow to a company's business due to reduced purchasing power and will reflect on its share price**

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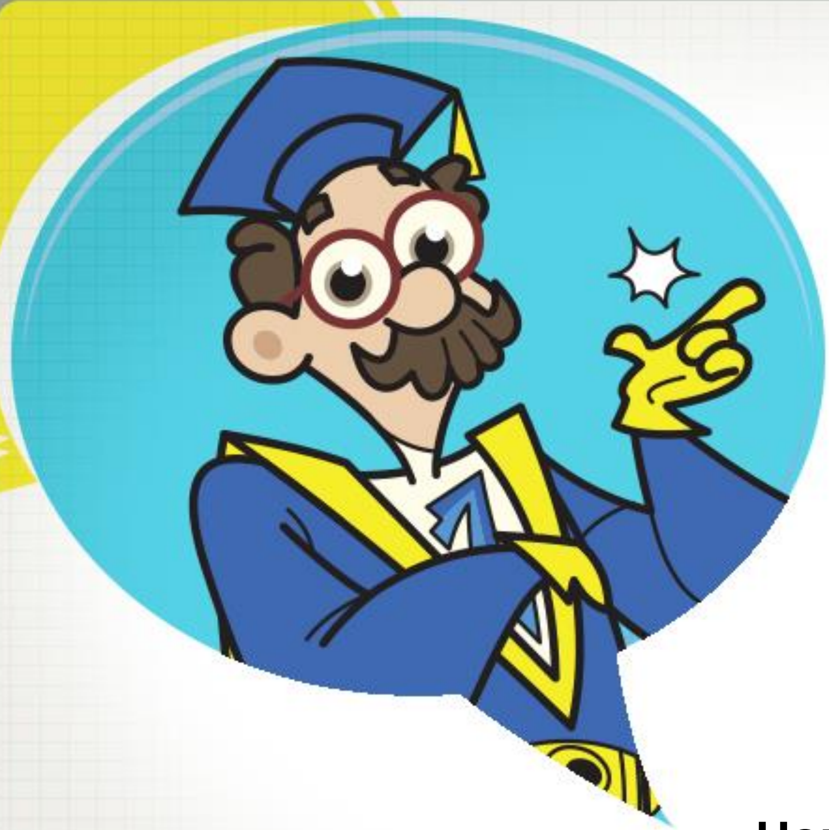

Hope you have now understood the concept of ADRs.

Thinking of Investment

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