



The Role of Depositary Receipts

For Corporate and Institutional Clients

INDUSTRY INSIGHT



GOING PUBLIC 上市

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中国企业在美国证券市场上市指南



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The role of depositary receipts

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A depositary receipt (DR) program is an effective option for non-US companies seeking to undertake global equity offerings. DRs have long been a popular instrument in worldwide capital markets, particularly where the elimination of custody and cross-border safe-keeping charges are a key concern.

The role of the depositary bank

A DR program is an effective option for non-US companies seeking to undertake global equity offerings. Issuers establishing DR programs may benefit from a broadened investor base, potentially increasing liquidity as a result of an expanded market, and enhanced visibility. From the investor perspective, DRs have long been a popular instrument in worldwide capital markets, particularly where the elimination of custody and cross-border safe-keeping charges are a key concern.

DRs were created in 1927 to assist US investors seeking to purchase shares of non-US corporations. Since then, DRs have grown into widely accepted, flexible instruments that provide issuers worldwide with access to investors outside their home markets. Historical and recent data points to the growing size of this opportunity. According to the US Federal Reserve, total

US investment in non-US equities including DRs and non-US shares has increased steadily over the last 19 years, rising from \$279 billion in 1991 to \$4.4 trillion in 2010. Additionally, overall DR trading volumes increased to 147.4 billion shares in 2010, growing at a compound annual growth rate of 19% since 2006, reinforcing the long-term trend of constant growth in cross-border trading. Specifically, capital raised in the form of DRs by non-US companies reached \$20.7 billion in 2010, a 26% increase over 2009.

Roles and relationships for the issuer and the depositary

In order to establish any type of DR program, the issuers assemble a team of advisors that typically includes investment bankers, lawyers and accountants. The issuer also selects a depositary bank, a key partner that enlists the services of a local market custodian to assist in the

implementation of the program.

Once the issuer and its advisors have evaluated the company's unique needs, and have determined the type of DR program best suited to its objectives, the issuer and the depositary execute a deposit agreement, a contract which sets forth the terms of the DR program. Based upon the contract, the depositary performs certain specific services on behalf of the issuer and the DR holders. Many of these same parties may play key roles in the long-term development and day-to-day management of the issuer's DR program. However, the depositary bank will remain a critical liaison between the issuer and brokers and investors, while the functions of lawyers and accountants become focused on periodic reporting. Typically, investment bankers are not involved with the DR program unless the issuer is going back to the market.

Role of depositary	Role of issuer
Consult on DR facility structure.	Determine corporate and financial objectives.
Appoint custodian.	Appoint depositary, legal counsel, investment bank and accountants.
Assist with DR requirements.	Determine program type.
Coordinate with lawyers and investment bankers to ensure that all the implementation steps are in place.	Obtain approval from board of directors, shareholders and regulators as needed.
Prepare and issue DRs.	Provide financial information to accountants and advisors.
Announce program establishment to investor community.	Develop and investor relations plan.

The role of depositary receipts

How to evaluate a depositary bank

The depositary bank plays a critical role for issuers that wish to expand their access to capital, broaden their investor base globally, and take advantage of all the benefits of DRs. The issuer and the depositary bank enter into a relationship that extends through the offering process and implementation stages and continues through the ongoing management of the DR program.

As a guideline for evaluating depositary banks, the issuer should consider the resources and track record of the provider, as well as its core competencies and value-added services.

Key questions to ask a depositary bank

Key questions include the following:

- How extensive is the depositary bank's expertise in securities processing?
- Can the depositary bank offer your company a complete range of banking and financial products?
- How is the depositary positioned with investors and other global market participants?
- What peers in your region and worldwide exemplify how the depositary has managed liquid DR programs?
- How many years of experience does the organization have in serving DR issuers in your region?
- What awards has the depositary bank won that represent a third-party endorsement of its superiority over its competitors?

The depositary's commitment to investor relations

The breadth of value-added services offered by a depositary can enhance a

TABLE 2 Roles in the ongoing development of a DR program

Role of depositary	Role of issuer
Issue and cancel DRs.	Provide required certificates to the DR bank and the issuance of DRs, if needed.
Serve as registrar and transfer agent for the DRs	Communicate with depositary regarding the DR program including potential program changes.
Act as paying agent, processing dividend payments or other entitlements for DR holders.	Pay dividends to local custodian for transfer to the DR holders.
Process corporate actions.	Communicate with depositary on corporate actions.
Provide ongoing account management support to the issuer.	Ongoing regulatory reporting and filing.
Coordinate proxy process for DR holders.	Communicate with depositary for shareholder services.
Offer value-added services such as investor relations counsel.	Develop investor relations plan.

company's internal investor relations (IR) effort and should be a crucial consideration for the issuer in selecting a depositary services provider. Citi pioneered the depositary's role of IR counsel, delivering the expertise and resources required for its sponsored issuers to achieve their international IR goals.

For example, where appropriate, a depositary's IR counsel may work closely with the issuer in formulating investor strategic plans and identifying, targeting and accessing new investors. IR counsel may also advise the issuer on financial

media relations, non-deal road shows, IR website development and the selection of outside IR firms. The depositary may also provide shareholder intelligence tools, delivering comprehensive share ownership and peer ownership data and analytical flexibility.

Features and benefits of depositary receipts

A DR is a negotiable instrument issued by a US depositary bank evidencing ownership of shares in a non-US corporation. Each DR denotes depositary shares (DSs),

representing a specific number of underlying shares on deposit with a custodian in the issuer's home market. The term "DR" is commonly used to mean both the physical certificate and the security itself.

DRs are generally subject to the trading and settlement procedures of the market in which they trade. The different types of DR are frequently identified by the markets in which they are available, or the rules and regulations associated with the structures. For example:

- American depositary receipts (ADRs) are DRs that are publicly available to investors in the United States; and
- Global depositary receipts (GDRs) are DRs that may be offered to investors in two or more markets outside the issuer's home country, usually pursuant to Rule 144A and Regulation S (Reg S) under the US Securities Act of 1933.

DRs can be publicly offered, privately placed or issued pursuant to an international offering. The structure of the DR program typically defines the segment of investors that can purchase the securities. In the United States, publicly offered securities are available to the broadest spectrum of investors and trade either on a national stock exchange (eg, NASDAQ or the New York Stock Exchange (NYSE)) or in the over-the-counter (OTC) market. GDRs are usually offered to institutional investors through a private offering, in reliance on exemptions from registration under the US Securities Act of 1933. These exemptions are Reg S for non-US investors and Rule 144A for US investors that are Qualified Institutional Buyers (QIBs). QIBs in the United States

include institutions that own and invest at least \$100 million in securities of non-affiliates and registered broker-dealers that own or invest on a discretionary basis at least \$10 million in securities of non-affiliates. A GDR offering often has a Rule 144A component as well as a placement to non-US investors pursuant to Reg S.

Benefits of a DR program specific to issuers and investors are highlighted in Table 3.

DRs can play a critical role in other types of cross-border transaction, such as privatizations and mergers and acquisitions.

Privatizations

The privatization of state-owned assets is an important undertaking for governments worldwide, as countries seek to restructure their economies and reduce fiscal deficits. Infrastructure and service enterprises such as telecommunications, utilities, airlines and petrochemicals are among those commonly targeted for privatization.

DRs have been used successfully by governments seeking to privatize state-owned enterprises. Privatizations require a successful offering of securities to investors, and DRs provide an effective mechanism

DRs enable issuers to:	DRs aid investors by:
Access capital outside the issuer's home market.	Facilitating diversification into non-US securities.
Build company visibility in the United States and/or internationally.	Trading, clearing, and settling in accordance with the practices of the investor's home market.
Broaden and diversify their shareholder base.	Eliminating cross-border custody safe-keeping charges.
Increase opportunities to increase local share prices as a result of global demand/trading.	Enhancing accessibility of research, and of price and trading information.
Enlarge the market for the company's shares, potentially increasing liquidity.	Allowing easy comparison to securities of similar companies trading in the investor's home market.
Adjust share price levels to those of peers through a DR ratio.	Permitting dividend payments in US dollars and corporate action processing.
Utilize DRs to facilitate M&A activity through use as acquisition currency.	Enabling uniform proxy and corporate action processing.
Develop stock option plans and stock purchase plans for employees outside the issuer's home market.	Providing opportunities to move between markets.

The role of depositary receipts

both to increase private ownership and to raise capital overseas.

M&A

DRs can enhance the ease of trading and settlement related to cross-border mergers and acquisitions; they also can facilitate the execution of corporate actions such as payments of dividends, structuring of rights offerings and solicitation of votes. DRs enable issuers to address investor demands without the need to build an independent US shareholder support infrastructure, or to modify the equity issuance and trading patterns of the home market. Types of M&A transaction that have made successful use of DRs include:

- spin-offs of non-US subsidiaries;
- equity-based acquisitions of US business entities; and
- equity-based acquisitions of non-US business entities.

Program alternatives

Issuers structure a DR program based on their particular objectives. An issuer's aims in selecting the best DR alternative may include:

- expanding its shareholder base;
- gaining international recognition for the company name and for its products and services; and
- using DRs as a capital-raising tool; and

- providing a convenient investment vehicle for its international employees.

Setting the ratio

A primary step in establishing a DR program is to determine the ratio of underlying shares to DSs. The share-to-DS ratio is established as a multiple or fraction of the underlying shares and this ratio can influence the price-trading range. In setting the ratio, the issuer should consider:

- industry peers – securities of companies in the issuer's industry generally trade in a certain price range and the issuer may want to conform to industry norms in the market where the DR will be listed;
- exchange options – each exchange has average price ranges for the shares listed and, generally speaking, issuers may want to conform to that range; and
- investor appeal – US institutional and retail investors are more likely to buy shares that they perceive to be well priced and valued fairly.

While many DR programs are established with a 1:1 ratio (one underlying share equals one DS), DR programs have been known to have ratios ranging from 100,000: 1 to 1:100. The depositary will work with issuers to determine the most appropriate ratio at the inception of the DR

program. In addition, the ratio can be adjusted at a future date, for example, to address changes in market conditions.

Types of DR program

In the United States, DRs can be:

- traded over the counter through Pink Sheets or OCTQX (Level I);
- listed on a US exchange such as the NASDAQ Stock Market or the NYSE (Level II);
- issued as a public offering of securities on a US exchange (Level III);
- placed with QIBs in the Rule 144A market; and
- placed outside the United States with non-US persons in accordance with the US Securities Act (Reg S) – note that Reg S programs are often offered in global markets in conjunction with 144A programs in the US market.

Program alternatives

US-listed DR programs

Listing on one of the US national exchanges can promote comparatively active trading in ADRs versus a Level I and increase the issuer's visibility within the United States, as listed ADRs typically receive wider research coverage by US analysts and the financial media, hence providing investors with increased information about the issuer and its securities.

TABLE 4

DR program alternatives to broaden shareholder base with existing shares

	OTC Level I	Exchange-traded Level II
Description	Unlisted program in the United States.	Listed program on a recognized US exchange.
Trading	Quoted in the Pink Sheets and/or on the OCTQX.	NYSE or NASDAQ.

Issuers can also use ADRs to access institutional investors that may be prohibited or limited by their respective charters, or by regulation, from investing in non-US securities purchased in the issuer's home market. US investors may prefer to purchase ADRs rather than shares in the issuer's home market as the DR securities trade, clear and settle according to US market conventions.

To list its ADRs in the United States, the issuer must comply with the requirements of the relevant stock exchange. The issuer must register under the Securities Act and the Securities Exchange Act of 1934 and file an initial registration statement and periodic financial reports. Non-US issuers that are listing their securities must reconcile all financial statements to US generally accepted accounting principles (US GAAP) or international financial reporting standards (IFRS), as published by the International Accounting Standards Board. Financial reporting for individual business segments need not be reconciled to US GAAP or IFRS. Listing securities exempts non-US issuers from complying with various state securities regulations.

In a Level III program, the issuer offers new shares to US investors in ADR form. A

public offering provides the issuer with the ability to raise capital by accessing the broadest US investor base. In order to conduct an initial public offering (IPO) in the United States, the issuer must:

- submit Form F-1 to the Securities and Exchange Commission (SEC) to register the underlying securities to be offered;
- fully reconcile its financial statements to US GAAP or IFRS (or include US GAAP financials); and
- submit Form F-6 to the SEC to register the ADRs with the depositary.

In establishing a Level III ADR program, the issuer also selects an investment bank to advise on and underwrite the offering and to market the ADRs to US investors. Once the offering has been completed, the program is maintained as a listed facility and can typically accept ongoing deposits from investors. An issuer may also raise capital in subsequent offerings. In such a follow-on offering, the issuer may file a Form F-2 or Form F-3 with the SEC.

Rule 144A DRs

Rule 144A DRs are DRs that are privately placed in the United States. These DRs are

traded pursuant to Rule 144A which, adopted in 1990, greatly increased the liquidity of privately placed securities by allowing QIBs to resell those securities privately to other QIBs without a holding requirement or other formalities.

GDRs

GDRs allow an issuer to raise capital through a global offering. Global offerings allow issuers to access shareholders in capital markets outside the issuer's home market. GDRs use a global settlement convention which may include the Depositary Trust Company, Euroclear and Clearstream to provide global clearing and settlement, ultimately promoting increased liquidity through cross-border trading.

GDRs can be issued in either the public or private market. Most GDRs include a US tranche, which can be privately placed under Rule 144A, and an international tranche placed pursuant to Regulation S outside the United States – typically in the Euromarkets. GDRs placed in Europe are often listed on the Luxembourg or London Exchanges.

Several additional listing destinations have become viable, potentially expanding the opportunities for DR issuers. These

TABLE 5 DR program alternatives to raise capital with new shares

	Public offering Level III	Rule 144A DR	GDR
Description	Offered and listed on a recognized US exchange.	Private placement in the United States to QIBs.	Global placement outside the issuer's home market; this may include a 144A DR and/or Reg S offering.
Trading	NYSE or NASDAQ.	QIB Market networks in the United States.	London Stock Exchange, Luxembourg Stock Exchange or others.

include the Singapore Exchange Limited and the Dubai International Financial Exchange.

The evolution of regionally specific DRs is evidence of the flexibility of the GDR, allowing issuers to select the investor base they wish to access and broaden their shareholder base into new markets. For example, an issuer could establish a GDR program that targets European, Asian and/or Latin American investors and does not offer shares in the United States. Over time, the GDR program could be enhanced to reach additional markets and investors.

Upgrading a GDR to a publicly listed program

A non-US company may decide to list its DRs subsequent to its global Rule 144A and Regulation S offering. Upgrading from a GDR to a US-listed ADR program is a viable option for companies wishing to achieve greater global reach and visibility. Although the Regulation S tranche easily may be moved to a listed facility 40 days after the Regulation S offer, generally a Rule 144A tranche is slightly more challenging. A Rule 144A facility cannot actively coexist with a US-listed program. In order to upgrade the Rule 144A facility to a listed program, the issuer will typically first need to file a Form F-4 registration statement pursuant to the Securities Act. After the F-4 registration statement has been filed, a registered exchange offer with the QIBs may be undertaken. Under certain circumstances, and if the Rule 144A program is “seasoned,” the issuer may opt for a private exchange using a certification process rather than a registered exchange under the Securities Act.

Issuance and cancellation of DRs

Based upon availability and market conditions, an investor may acquire a DR either by purchasing existing DRs or by converting shares purchased in the issuer’s home market to DRs. New DRs are issued subsequent to the deposit by an investor or broker of shares with the depositary’s local market custodian. The depositary then issues DRs, which represent the shares on deposit, to the investor or broker. This is referred to as an issuance of DRs.

Conversely, an investor may cancel the DRs and sell the underlying ordinary shares in the relevant home market upon delivery of the DRs and of cancellation instructions to the depositary, which in turn cancels the DRs and notifies its custodian to release the underlying shares according to the investor’s instructions. The broker may then either safe keep or sell the ordinary shares in the local market.

Liquidity

For many DR market participants, liquidity – the consistent breadth and depth of trading activity – is considered the best measure for long-term success of a DR program. Without the ability to move into and out of positions of sufficient size, institutions are often reluctant to add the security to their managed portfolios. Likewise, brokers prefer to deal in liquid issues, and both sell-side and buy-side analysts prefer to cover liquid securities with high standards of financial disclosure providing an important added protection. Once established liquidity can be facilitated and maintained through a strong investor IR effort and the resources of the depositary bank and other partners.

The findings of Citi’s “The Liquidity Premium” study (published in 2007 by the

Rutgers University School of Law Business Law Journal) built upon academic research showing that firms cross-listed on a US exchange, such as the NYSE or NASDAQ, benefit from, on average, a sustainable valuation premium of 33% over companies that do not cross-list. The Citi study demonstrated that, on average, companies with liquid DRs, whether cross-listed or direct listed, had higher valuations, as measured by their price-to-book-value ratios, than those with fewer liquid DRs.

Limited two-way market

Some countries maintain restrictions on the re-issuance of DRs. In this limited two-way market environment, after withdrawal and sale of ordinary shares from the DR facility, the shares are subject to limitations on redeposit into the DR facility. Deposits may, for example, occur only up to a certain limit. Once that limit has been reached, the DR facility may be closed for re-issuance pending receipt or required permissions. In contrast, most countries have an unlimited or free two-way market, where foreign investors may purchase at any time, outstanding ordinary shares in the local market for deposit into the DR facility.

Relaxed restrictions may benefit issuers through:

- increased possibility for immediate issuance of DRs;
- enhanced liquidity over time – the ability to issue and cancel the company’s DRs potentially enhances trading activity. The associated advantages are higher investor demand and higher valuation;
- decreased risk resulting from lower share price volatility – due to larger pool of a company’s stock, changes in supply and

- demand yield smaller price changes; and
- broadened opportunity for non-US investment in the local market.

A DR premium is the differential between the ordinary share price in the local currency and the price of the DR. Historically, when the US market outperforms the non-US market, the premium grows. When the local market outperforms the US market, the premium typically shrinks. The limited two-way market promotes cross-border liquidity up to a point; however, it may not significantly reduce the size of the DR premium as compared to an unlimited and two-way market.

US securities regulations and DRs

Issuers of DRs must comply with the regulations of the markets in which their DRs are issued. In the United States, the SEC was created as an independent agency of the US government to enforce federal securities laws governing securities offerings, trading practices and persons dealing in the securities markets. The SEC protects US investors and US markets by requiring disclosure of material facts concerning issuers making public offerings of securities. The SEC is empowered to issue regulations and enforce provisions of both federal securities laws and its own regulations.

Two key US securities laws with which DR issuers must comply are the:

- Securities Act of 1933; and
- Securities Exchange Act of 1934.

The primary intention of the Securities Act is to provide investors with full and fair

disclosure of material information regarding an issuer in connection with the offer and sale of its securities. The Securities Exchange Act is different in that its primary intention is to provide investors trading securities in the secondary market with access to full and fair disclosure of material information about an issuer on an ongoing basis.

With the arrival of the more stringent regulatory climate in the United States, some DR issuers initially felt a need to reassess the costs compared to the benefits of their US listings. Many did not see the US regulatory climate as an obstacle, given that most countries have tightened their compliance rules in recent years. In fact, many equities markets outside the United States are known to have equally strict, and perhaps even stricter, corporate governance requirements. Some IR experts argue that more stringent standards represent an opportunity for companies to differentiate themselves. When investors calculate the risk/reward equation, there is a greater “comfort factor” with companies known to have cleared certain regulatory hurdles.

The SEC noted issuer concerns regarding some of the burdens caused by recent corporate governance legislation. For example, the SEC has applied and is continuing to evaluate certain exemptions for non-US companies from provisions of the Sarbanes-Oxley Act. In addition, a series of reforms came into effect in December 2005 impacting the securities offering process in the United States. These measures are expected to simplify access to the US capital markets for both US and non-US companies, including those issuing DRs.

Conclusion

DRs are a winning proposition for global financial markets, benefiting non-US issuers and international investors alike. For issuers, a DR program can serve to broaden and diversify a company’s shareholder base, enlarging the market for its shares and potentially increasing liquidity. DRs are attractive to investors worldwide who are looking to eliminate cross-border custody safe-keeping charges and enhance the accessibility of research and price and trading information.

The depositary is a key partner for the issuer, both in establishing a DR program and in developing and managing the program on an ongoing basis. The role of the depositary in a UK program establishment includes advising on DR facility structure, and coordinating with lawyers and investment bankers to ensure that all implementation steps are completed. On an ongoing basis, the critical role of the depositary includes issuing DRs and providing ongoing account management and IR support to the issuer.

A crucial consideration for the issuer in selecting its depositary is the depositary’s experience and a program of value-added services, which should be designed to complement the company’s IR effort.

Citi's ADR programs for Chinese companies

Citi's Depositary Receipt Services is the market leader in China, which is reflected in the largest number of new listing mandates won in recent years on the back of its service quality and dedicated team on the ground. In 2010, approximately \$5.3 billion in capital (for both IPOs and follow-on offerings) was raised in China in DR form. Citi led the way in DR IPOs, raising more than \$1.9 billion in DR form – capturing 47% of the IPO market share in China. Its team in Asia provides dedicated services to issuers before their offering listing, as well as ongoing support after their listing. This includes its IR services, which comprise training and a range of visibility programs that help issuers enhance communication with relevant investor groups in the United States.

Citi's Depositary Receipt Services business has been recognized by *The Asset* magazine for seven consecutive years. Most recently, Citi was named best ADR bank in 2011 and best GDR bank in 2010 by the magazine.

About Citi's Depositary Receipt Services

Depositary Receipt Services, a business within Citi Global Transaction Services, is a leader in bringing quality issuers to US and global capital markets, and in promoting DRs as an effective capital markets tool. Citi began offering DRs in 1928 and today is widely recognized for providing non-US companies with access to the powerful global platform Citi has to offer. For information about DRs visit www.citi.com/adr.

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Global Transaction Services

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