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A Little help with ADRs

ADRs, or American Depository Receipts, offer investors access to individual non-US companies. With over 1000 ADRs, the challenge becomes identifying which ADRs are most appropriate for a portfolio. Fortunately, our US research providers, including S&P, Credit Suisse First Boston, and Bear Stearns cover a number of these ADRs.

The article below offers a brief overview of ADRs, including the currency risks to a Canadian investor. Additionally, a new user-friendly tool is described. This tool can help you identify a specific ADR, its sector, geography, and stock rating from all three research providers. The tool will be updated on a weekly basis to include any ratings changes and/or new coverage initiations.

What is an ADR?
An ADR, or American Depository Receipt, is a security that represents a non-US company's publicly traded stock. The ADR is typically created when a US bank purchases a foreign company's shares in the domestic market, and re-issues them in the US, often as a bundle of domestic shares (one ADR may not equal one share).

Another form of depository receipt, known as a GDR, or Global Depository Receipt, is similar to an ADR with the exception being that the security is not registered with the SEC, and may be restricted in terms of resale.

Why use ADRs?
While ETFs, or exchange traded funds, can be used by investors to gain broad exposure to international markets, there are only two ways to gain exposure to individual foreign equities: 1) buy the shares on a foreign exchange or 2) buy an ADR. ADRs offer the following benefits relative to buying shares via international markets:

- Trades on major US stock exchanges
- Lower transaction and custodian fees
- Greater visibility, with access to live pricing data and quotation in US dollars
- Payment of dividends or interest in US dollars
- Familiar trade, clearance, and settlement procedures
- Ability to acquire underlying securities directly upon ADR cancellation
- Enhanced liquidity
- Greater analyst coverage

What are the risks?
In addition to the traditional risks involved in investing in equities, such as marked, industry, and business risks, international investors must also consider the following:

- Political Risk – generally country or region specific
- Liquidity Risk – daily volume is a good indication of an ADR's liquidity
- Exchange Rate Risk – foreign currency appreciation/depreciation

The latter point is widely misunderstood by many investors. As previously mentioned, an ADR represents a share, or a basket of shares, of a foreign company's publicly traded shares. As such, the price of an ADR, in US dollars, reflects the currency-adjusted appreciation or depreciation of the foreign stock's move in its own domestic market. In other words, the ADR reflects:

- The price of the foreign stock on its domestic exchange
- The value of the foreign currency relative to the US dollar

This is best illustrated in the example below, which highlights shares of **Canon**, a Japanese stock whose ADR symbol is CAJ. In the example below, the Canon ADR returned 2.3% during the February – June 13th timeframe. In the Japanese stock market, the stock returned 8.33%. However, the Yen depreciated by 5.36%, resulting in an overall return of 2.53% for a US investor. The difference in total returns below can be attributed to timing and transaction costs. The example below demonstrates an ADR's exposure to the underlying equity's domestic price move as well as the change in its domestic currency.

Date	**BUYING CANON IN ADR FORM**	**BUYING CANON IN JAPAN**	**EXCHANGE RATE**
	CAJ	7751 JP	Yen/USD
	$USD	Yen	
31-Jan-05	52.58	5400	103.7
13-Jun-05	53.79	5850	109.57
		8.33%	-5.36%
	2.30%	**2.53%**	

Importantly, from a Canadian perspective, there is additional currency risk. A Canadian investor would have to convert $CAD based funds into $USD and then purchase the Canon ADRs. Using the example above, the additional currency risk (between the US and Canadian dollars) can be seen in the revised table below. During the same time frame, the US dollar appreciated 0.95% relative to the Canadian Dollar, thereby increasing the overall return from 2.3% to 3.57%.

Date	**BUYING CANON IN ADR FORM**	**EXCHANGE RATE**
	CAJ	$CAD/USD
	$USD	
31-Jan-05	52.58	1.2398
13-Jun-05	53.79	1.2552
		1.24%
	2.30%	**3.57%**