Level I ADRs
A reference guide for issuers

November 2008
Introduction

Non-U.S. issuers are increasingly turning to Level I American Depositary Receipts (ADRs) as an expedient and cost-effective way to access the U.S. equity market, the largest and most liquid in the world. Level I ADRs are a relatively simple way to attract U.S. investors, which can broaden a foreign issuer’s shareholder base as well as generate incremental demand for the shares underlying the ADRs. Under U.S. securities laws, the disclosure and reporting requirements for a Level I ADR program are minimal, which can make it the most attractive option for a company choosing not to list on the NYSE or NASDAQ through a Level II facility and not seeking to raise capital via a Level III program.

The key differences between Level I, II and III ADRs

Level I ADRs are not listed on a U.S. stock exchange, but trade in the over-the-counter (OTC) market, most commonly via the Pink Sheets electronic market.* These ADR facilities have been growing in number, largely due to the implementation of more stringent reporting and regulatory requirements that Level II or III programs must meet under the U.S. Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) and the U.S. Securities Exchange Act of 1934 (Exchange Act). For many foreign companies, the direct and indirect costs imposed by the current regulatory environment outweigh the advantages of a Level II or Level III ADR program.

Unlike Level III ADR programs, a Level I program cannot be used to raise capital in the U.S. In addition, a Level I program may not achieve the visibility and trading liquidity associated with Level II programs, which are listed on a U.S. securities exchange. Level II issuers may also be better positioned to move to a Level III program to raise capital, as they may qualify to use a short-form registration statement that is not available to Level I issuers. However, a Level I ADR program offers a foreign company the opportunity to diversify its shareholder base and raise market valuation by giving U.S. investors an easier way to purchase its securities, among other benefits.

Advantages of a Level I ADR program

- The simplest and most cost-effective type of ADR to establish
- An issuer can maintain home market accounting and disclosure standards and is not required to reconcile its financial statements to US GAAP
- Exemption from U.S. reporting requirements under SEC Rule 12g3-2(b), which was amended in October 2008 to make it easier for qualifying companies to establish Level I ADR programs
- Exemption from disclosure and regulatory requirements of the Sarbanes-Oxley Act
- Registration of the ADRs under the U.S. Securities Act of 1933 (the “Securities Act”) is straightforward, as the only filing required is Form F-6, a short-form registration statement; the underlying ordinary shares are exempt from registration

Challenges of a Level I ADR program

- Level I ADR issuers cannot raise capital from U.S. investors other than in a private offering (e.g., to Qualified Institutional Buyers as defined under SEC Rule 144A); also, Level I ADRs cannot be used as U.S. acquisition currency
- Generally, foreign issuers trading OTC attract less sell side analyst and media coverage than exchange-listed companies
- Some U.S. institutional investors have investment strategies or charters that preclude them from holding securities traded over-the-counter; others might simply be unfamiliar with the OTC market
- Public ownership data for Level I ADRs is less extensive than for exchange-listed securities, making it more difficult for a foreign issuer to track U.S. shareholdings and measure the effectiveness of investor relations efforts

* Level I ADRs are not eligible for quotation on the Over-the-Counter Bulletin Board (OTCBB), as this market only accepts companies that are subject to U.S. reporting requirements.
Establishing a Level I ADR program for your company

J.P. Morgan can advise and assist you in establishing and maintaining a Level I ADR program. Establishing your depositary receipt program will require close coordination between your company, J.P. Morgan as your depositary bank and each firm's legal counsel. J.P. Morgan will select a custodian bank on your behalf in your home market. In addition, both listed and unlisted ADR issuers should develop and implement a focused investor relations strategy and plan for the U.S. equity market.

**J.P. Morgan as Depositary Bank**
- Advises on optimal type of ADR program to implement and on exchange or market on which to list or quote
- Advises on ratio of depositary shares to ordinary shares
- Appoints custodian
- Coordinates filing of Form F-6
- Coordinates program implementation with all parties
- Coordinates with legal counsel on Deposit Agreement and securities law matters
- Prepares and issues certificates and/or direct registration account statements
- Solicits market makers
- Announces DR program to market (brokers, traders, media, retail/institutional investors via news releases and Internet)

**Issuer**
- Provides Depositary and Custodian with notices of dividends and corporate actions, including notices of annual and special stockholder meetings
- Ensures ongoing compliance with U.S. law, including electronic publication of home country disclosure documents under Rule 12g3-2(b) (coordinating with legal counsel)
- Executes U.S.-focused investor relations program

**Legal Counsels of Depositary and Issuer**
- Prepare draft Deposit Agreement (Depositary Bank's counsel) and file Form F-6 with the SEC
- Assist issuer with U.S. securities law compliance, particularly maintaining the Rule 12g3-2(b) exemption from registration and reporting

**Custodian Bank**
- Receives local shares in issuer's home country
- Confirms receipt and deposit of underlying shares
- Holds shares in the depositary's account in the home market
- Releases shares to beneficial owners upon cancellation of ADRs
Setting a ratio

Each ADR issued by a company represents a certain number of the underlying shares that are held in custody in your company’s home market. The ratio between ADRs and underlying shares is set by the foreign issuer, often based upon the share prices of its U.S. industry peers and/or the ADRs of non-U.S. peers. As a general rule of thumb, you will want to carefully review the share or ADR prices of your peers in order to determine and assign a ratio that will initially result in a similar price per ADR for your company; of course, the ratio that you choose will have no impact on your company’s market valuation. Establishing a ratio that initially results in a price per ADR that is roughly equivalent to your peers’ U.S. shares and/or ADRs, addresses two common concerns of some foreign issuers:

- that some U.S. investors or other constituents might mistakenly interpret a relatively low ADR price as an indication that there is a problem with the company,
- that a relatively high ADR price might give some investors the impression that an issuer is too expensive to purchase.

Sample implementation timetable

<table>
<thead>
<tr>
<th>Action</th>
<th>Parties involved</th>
<th>Weeks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establish and organize transaction team.</td>
<td>I = Issuer</td>
<td></td>
</tr>
<tr>
<td>Begin planning U.S. investor relations program: create communications materials, make Web site enhancements, target institutional investors and determine ADR ratio.</td>
<td>D = Depositary Bank</td>
<td></td>
</tr>
<tr>
<td>Confirm eligibility for Rule 12g3-2(b) exemption from Exchange Act registration.</td>
<td>L = Legal Counsel (for Depositary and/or Issuer)</td>
<td></td>
</tr>
<tr>
<td>Negotiate and execute Deposit Agreement.</td>
<td>IB = Investment Bank</td>
<td></td>
</tr>
<tr>
<td>Prepare Form F-6 and submit to SEC along with Deposit Agreement.</td>
<td>IR = Investor Relations team</td>
<td></td>
</tr>
<tr>
<td>Form F-6 is declared effective by SEC.*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Solicit market makers via Form 211.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Complete requirements for OTC trading and settlement: obtain DTC eligibility, CUSIP number, ticker symbol; prepare ADR certificates.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Program launches and trading begins following ADR “issuance” against underlying shares deposited.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Place tombstone advertisement (optional).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distribute press release and broker announcement to media and investment community via newswire, Internet and e-mail.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conduct roadshow meetings with key investors in the United States.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* A Form F-6 can be declared effective by the SEC between 5 and 30 days after filing with the SEC.

Time frames provided are indicative. Regulator’s involvement and issuer’s program specifics may vary and can materially affect timing.

Key to parties involved: I = Issuer D = Depositary Bank L = Legal Counsel (for Depositary and/or Issuer) A = Accountant IB = Investment Bank IR = Investor Relations team
Recent regulatory changes that have benefited Level I ADR programs

Amendments to Rule 12g3-2(b)

Historically, Rule 12g3-2(b) under the Exchange Act has provided a means for Level I ADR issuers to obtain an exemption from the Act’s registration and reporting requirements. Effective October 2008, the SEC adopted amendments to Rule 12g3-2(b) that are designed to make it easier for foreign companies to establish and maintain this exemption.

Application for exemption eliminated

Under the amendments to Rule 12g3-2(b), the SEC eliminated the application process for establishing an exemption, which is now automatically available to any foreign private issuer that meets the requirements under Rule 12g3-2(b). Previously, in order to obtain exemption from Exchange Act registration and reporting requirements, issuers were required to submit a formal written application to the SEC together with certain disclosure documents, as well as information about the company’s most recent capital raising activities and its U.S. shareholders.

Conditions required to establish an exemption

Under amended Rule 12g3-2(b), the exemption can be established by any foreign private issuer that:

(i) maintains a listing on a “primary trading market” defined as a foreign market which, either alone or together with another foreign market, accounted for at least 55% of the issuer’s worldwide average daily trading volume during its most recent fiscal year. If two foreign markets are combined to meet the 55% threshold, at least one such market must have greater trading volume in the issuer’s securities than exists in the United States;

(ii) publishes on its Web site, or through an electronic information delivery system, English translations or summaries of certain home country disclosure documents that the issuer made public, or was required to make public, since the first day of the issuer’s most recently completed fiscal year; and

(iii) is not otherwise subject to Exchange Act reporting requirements.

Ongoing requirements to maintain exemption

Once exemption from Exchange Act registration and reporting requirements has been established, an issuer must continue to electronically publish the required home country documents under Rule 12g3-2(b) on an ongoing basis in order to remain exempt.

As revised, Rule 12g3-2(b) is self-executing, with issuers having the responsibility to ensure that they meet all applicable conditions. Once established, the exemption remains in effect for as long as an issuer continues to comply with the requirements of the Rule. Issuers relying on Rule 12g3-2(b) have no obligation to notify the SEC of, or otherwise publicly disclose, the fact that they are claiming an exemption under the new rule.

Unsponsored ADRs

A potential drawback of the amendments to Rule 12g3-2(b) is that an issuer compliant with the Rule may find that an ADR program has been established without its knowledge or participation (sponsorship). Since companies meeting the relevant requirements are automatically exempt from registration, any depositary bank can unilaterally establish an unsponsored ADR program in anticipation of, or in response to, potential investor demand in the United
States. In order to do so, the depositary must have a good faith reasonable belief, after exercising reasonable diligence, that the issuer complies with the electronic publication requirements of Rule 12g3-2(b).

As an issuer is involved in neither the implementation nor the maintenance of an unsponsored ADR program, it has limited influence on the treatment of ADR holders. Moreover, multiple unsponsored ADR programs for the same issuer can be opened by competing depositary banks. Shareholder services often vary from depositary to depositary, creating potential investor confusion. For example, U.S. dollar disbursements may differ in some cases for the same payment, depending on the foreign exchange rate applied by each of the depositaries to the entitlements received in local currency. Additionally, depositaries charge investors for services according to their respective fee schedules, potentially frustrating ADR holders expecting consistent treatment in relation to holding the same security.

By sponsoring an ADR program with a single depositary, an issuer can ensure ADR holders are treated consistently and exercise a degree of control over how their ADR facility is operated. Once an issuer establishes a sponsored ADR, existing unsponsored programs must be terminated with the outstanding ADRs absorbed into the new facility. J.P. Morgan is well-positioned to guide an issuer interested in replacing an unsponsored ADR program with a sponsored Level I ADR program.

Amendment of trade reporting requirements for ADRs and foreign securities traded in the OTC market

In August 2008, the SEC approved a rule change proposed by the Financial Industry Regulatory Authority, Inc. (“FINRA,” formerly the NASD), amending the trade reporting requirements applicable to ADRs and foreign securities traded in the U.S. OTC markets.

Under the revised rule, securities broker-dealers will be required to report OTC transactions to FINRA within the same time frames for all securities, whether domestic or foreign. In addition, FINRA revised the protocols under which it publishes trading information to the marketplace. Last sale information, previously unavailable in real time for ADRs and foreign securities, will now be disseminated on a real-time basis for all OTC-traded securities.

Prior to these rule changes, real-time last sale information was not available for ADRs and Canadian securities quoted in markets other than the OTC Bulletin Board (OTCBB); for these securities, only summary information was disseminated at the end of each trading day. Since Level I ADRs are not quoted on the OTCBB, real-time sale information was generally unavailable for such programs. Under the new rule, FINRA will disseminate last sale information on a real-time basis for all transactions in OTC securities, including ADRs. This will enable investors to more effectively monitor trading activity and pricing for Level I ADRs and to better assess the execution of transactions.

Additional considerations for a Level I ADR program

Blue sky exemption

The first blue sky laws were enacted in 1919 after fraudulent promoters sold securities backed by nothing more than “clear blue sky.” Each U.S. state now has its own securities laws—commonly known as “blue sky laws”—that are designed to protect investors against fraudulent sales practices and activities. Laws can vary from state to state,
but most states typically require companies making securities offerings to register their offerings or establish an exemption from registration before securities can be sold in a particular state. The laws also license brokerage firms, the individual brokers at these firms and investment adviser representatives.

Since secondary market transactions are also subject to registration, without a “blue sky” exemption a retail broker cannot actively market or sell a Level I ADR. An exemption is generally available if a broker receives unsolicited buy or sell requests directly from clients. However, broader relief can be obtained under the “manual exemption.” The manual exemption is available in 39 states to ADR issuers that publish certain information in a securities manual published by a recognized source such as Mergent or Standard & Poor’s. Such information generally includes a description of the issuer’s business and operations, the names of the issuer’s officers and directors, and financial statements consisting of an audited balance sheet dated not more than 18 months prior to the date of a sale transaction and an audited income statement for each of the two most recent fiscal years. Many states also impose additional and sometimes varying requirements, such as: (i) the security must have been in the hands of the public for at least 90 days; (ii) the security must be sold at a price reasonably related to the current market price; and (iii) the issuer must have been engaged in continuous business for a specified period and/or have a specified minimum amount of total assets and/or gross income. The manual exemption is commonly relied upon for purposes of secondary trading, as it covers a large number of states and is relatively easy to establish.

J.P. Morgan can facilitate your obtaining a listing in a qualified securities manual for purposes of establishing a manual exemption.

OTCQX market

The Pink Sheets electronic market is an interdealer quotation system for OTC securities and is operated by Pink OTC Markets Inc. (Pink Sheets), a privately owned company. The OTCQX is a market tier developed by Pink Sheets to distinguish companies that provide certain levels of disclosure to investors and that meet certain other standards, with the aim of distinguishing them from other OTC-traded companies. Similarly, the International OTCQX is a segment created for Level I ADR issuers. However, the OTCQX utilizes the same electronic quotation platform as the general Pink Sheets market. Since its launch in 2007, foreign issuers have been monitoring the benefits of being quoted on the OTCQX.

In order to be listed on the International OTCQX, an issuer must: (1) maintain a listing on a foreign stock exchange; (2) appoint a “Principal American Liaison” (PAL), a U.S. market professional (investment bank, law firm or ADR depositary bank) that acts as liaison between the issuer and the U.S. market and is responsible for assisting the issuer with respect to U.S. market presence, disclosure requirements and compliance with U.S. securities laws; (3) maintain a Rule 12g3-2(b) exemption and post the information required thereunder on the Pink Sheets Web site; (4) have quotations published on the Pink Sheets by a market maker; and (5) be listed in the S&P or Mergent manuals for purposes of establishing blue sky exemption.

J.P. Morgan can facilitate an introduction to OTCQX and can serve as a PAL for foreign issuers who wish to be quoted on the International OTCQX and have a sponsored ADR program with J.P. Morgan.
Equity compensation plans

The establishment of a Level I ADR program gives an issuer the ability to implement equity compensation plans under which U.S. employees can receive ADRs rather than ordinary shares, which may be difficult to trade in the U.S. market. However, Level I ADR issuers must structure their plans in a manner that does not create an obligation to register the plan or the plan securities under the Securities Act. The principal exemptions that exist under the Securities Act for equity compensation plans of Level I ADR issuers are as follows:

Stock option plans under Rule 701

Level I ADR issuers can issue employee stock options pursuant to the exemption provided under Rule 701 of the Securities Act, which permits nonreporting companies to issue limited amounts of securities under a compensatory plan. During any rolling 12-month period, the maximum number of securities that can be issued under Rule 701 is the greatest of the following:

(i) securities having an aggregate sales price of $1 million;

(ii) securities having an aggregate sales price equal to 15% of the issuer’s total assets; or

(iii) securities in an amount equal to 15% of the issuer’s total outstanding securities.

The sales price of issued securities is based on the exercise price of the option on the date it was granted. To determine the number of securities issued, all shares underlying a stock option are deemed to be sold on the grant date, whether or not the option has vested or is actually exercisable on that date.

The issuer must adopt a formal written stock option plan or enter into a written agreement with each person receiving options, and each participant must receive a copy of the plan or a written agreement. If the aggregate sales price of options issued exceeds $5 million during any 12-month period, certain additional disclosure must be provided to employees, including (i) a summary of the material terms of the plan, (ii) information about the risks associated with an investment in the securities sold under the plan and (iii) certain unaudited financial statements, which must be reconciled to US GAAP (except for financial statements prepared under IFRS, which can be provided without reconciliation).

Securities issued to employees under Rule 701 are subject to restrictions on resale. In general, upon the exercise of a stock option issued under Rule 701, the underlying shares must be held for a one-year period after the exercise date before they can be sold in the public markets. However, a more favorable holding period can be attained through the use of cashless exercise, meaning that the exercise price is not paid in cash, but instead the number of shares issuable upon exercise is reduced by such number of shares having a market value equal to the exercise price. If stock options provide for cashless exercise, then the one-year holding period commences from the date on which the options were granted rather than the option exercise date. Therefore with a cashless exercise feature, a grantee is not required to exercise an option and then hold the shares for one year, but can instead hold the options themselves for a year and thereafter have the ability to exercise and immediately sell the underlying shares at any time.
Dividend reinvestment and stock purchase plans

Dividend reinvestment and stock purchase plans are exempt from registration under the Securities Act if structured in accordance with certain conditions promulgated by the SEC. The key conditions are as follows:

- The plan must be administered by an independent agent not affiliated with the issuer
- The plan must only acquire stock through open market purchases and not from the issuer
- The issuer must not solicit employees to participate in the plan, which can be done only by the agent within specific limitations
- The issuer can only perform certain limited ministerial functions related to the plan, and can only engage in limited promotional activities (such as providing a copy of the plan brochure to new employees or at the time a plan is first announced), in each case as specified in guidance issued by the SEC
- The agent’s promotional activities must be limited to (i) providing plan brochures upon request, (ii) posting a notice on its Web site regarding the availability of a plan and providing links to plan materials, and (iii) including a plan brochure in issuer-paid mailings to shareholders (such as proxy material) on a quarterly or less frequent basis

The issuer can contribute to employees’ share purchases so long as the amounts contributed by the issuer match or exceed employee contributions.

Stock bonus plans

If securities are awarded to employees without a requirement that the employees provide payment or consideration of any kind, the employees are not deemed to make any investment decision, and therefore the plan is not subject to registration under the Securities Act. This includes restricted stock awards where no payment is required from the employee.

Summary

For many foreign issuers, a Level I ADR program provides an effective and inexpensive alternative for accessing the U.S. equity market to achieve various strategic goals, such as expanding and diversifying a company’s shareholder base, increasing demand for the home market shares, and enhancing a company’s visibility in the U.S. and other important economies. J.P. Morgan can provide issuers with extensive guidance and assistance in assessing the benefits of establishing a Level I ADR program and can assist with the program’s implementation and ongoing maintenance.

We believe the information contained in this material to be reliable but do not warrant its accuracy or completeness. Neither JPMorgan Chase Bank, N.A. nor any of its affiliated companies shall be liable for any loss or damage of any kind arising out of the use of the information contained herein, or any errors or omissions in its content. This material does not constitute an offer or solicitation for the purchase or sale of any financial instrument. JPMISI or its broker-dealer affiliates may hold a position, trade on a principal basis or act as market maker in the financial instruments of any issuer discussed herein or act as an underwriter, placement agent, advisor or lender to such issuer.

In the United Kingdom (U.K.) and European Economic Area: Issued and approved for distribution in the U.K. and the European Economic Area by J.P. Morgan Europe Limited (JPMEL). In the U.K., J.P. Morgan Chase Bank, London Branch and J.P. Morgan Europe Limited are authorized and regulated by the Financial Services Authority. Additional information is available upon request.

Copyright 2008 JPMorgan Chase & Co. All rights reserved.