

Technology sector

Theme piece

FAQs on sponsored ADS

Frequently asked questions (FAQs) related to sponsored ADS

The proposed sponsored American Depository Shares* (ADS) issue by Infosys has raised many queries from several quarters. In response to these queries, we have answered some FAQs, which will provide clarity on most concerns. Issues covered include the current ADS float, size of the ADS, acceptance process, current & historical ADS premium, timelines and impact on domestic prices. We believe:

1. The current sponsored ADS issue will be completed before the end of November '06. This is unlike what happened in the past two sponsored ADSs of Infosys, when there was almost 6-7 months difference between the date of the announcement and pricing of the ADSs. This is because, at present, Infosys does not require an SEC approval since it has been classified as a 'seasoned issuer of equities in the US'.
2. Since acceptance in case of sponsored ADS is based on the proportionate allotment basis i.e. proportional to the total shareholding of the offering shareholders, bigger shareholders get a higher acceptance ratio.
3. Unlike the two previously sponsored ADS issues of Infosys, the current ADS premium (over the domestic) is low and therefore the possibility of a sharp shrinkage in ADS premium looks unlikely. Even then, some shrinkage will be seen (in the past two issues, the ADS premium contracted 7-8%). On the basis of Infosys' previously sponsored ADSs, we believe, ADS premium contraction is more due to a rise in the company's domestic share price rather than a fall in the ADS price.

What is the basis of acceptance in sponsored ADS?

Acceptance in sponsored ADS is based on proportionate allotment basis i.e. proportional to the total shareholding of the offering shareholders. The following paragraph, an excerpt from Infosys' prospectus filed during the first sponsored ADS with the US Securities and Exchange Commission (SEC), describes the process.

"...If the aggregate number of offered equity shares is equal to or less than the number of equity shares underlying the ADS finally sold in the offering, then all the offered equity shares will be accepted. If the aggregate number of offered equity shares exceeds the size of the offering, the proportion formula will be applied in the following manner:

- 1) Compute the **existing shareholding** of each selling shareholder as on the offer closing date

* Sponsored ADS is an issue of additional ADS against a block of existing equity shares by shareholders

- 2) Determine the **proportion** that each selling shareholder's existing shareholding bears to the aggregate shareholding of all the selling shareholders as on the offer closing date
- 3) Compute the **proportionate allocation** i.e. the number of offered equity shares to be accepted from each selling shareholder. This will be the rounded off product of each selling shareholder's proportion and the size of the offering.
- 4) For shareholders who have an allocation in excess of the deposited equity shares, calculate the **excess allocation** shares by subtracting deposited shares from the allocated shares.
- 5) Repeat steps 1 to 4 with respect to the excess allocation shares resulting from each round of allocation among remaining selling shareholders."

An example

If total equity shares are 1,000, the size of the conversion to ADS is 60 shares. Assuming only three shareholders A, B and C with individual shareholding of 100, 50 and 50 shares respectively, deposit 20, 40 and 30 shares of their holdings respectively for conversion.

Proportion calculation: A's proportion is 50% ($=100/200$), B's proportion is 25% ($=50/200$) and C's is also 25% ($=50/200$)

Proportionate allocation: A's allocation is 30 shares ($=50\%$ of 60), B's allocation is 15 shares ($=25\%$ of 60) and C's is also 15 shares ($=25\%$ of 60)

Excess allocation: As A has deposited only 20 shares, the excess allocation is 10 shares ($=30-20$)

Repeat of previous steps for B and C: Between B and C proportion is 50% each ($=50/100$). The allocation for B is five shares ($=50\%$ of 10) and for C is also five shares ($=50\%$ of 10)

Therefore, of the 20 shares offered by A, all 20 shares are accepted, while of the 40 shares offered by B, 20 are accepted. Further, of the 30 shares offered by C, 20 are accepted.

What is the size of the proposed sponsored ADS?

As per the Infosys announcement, the size of the proposed sponsored ADS issue is 30mn equity shares or 5.40% of total equity. In the previous sponsored ADS issue (in May '05), 16mn equity shares were offered.

What percentage of Infosys' current equity is in the ADS form?

Table 1 gives the data related to total number of equity shares, the percentage of equity in ADS form and the current holdings by FIIs + NRIs/OCBs.

Table 1: ADS holding#

	Bloomberg Code	Total Number of equity shares (mn)	FII Holding (a) (%)	NRI/OCB (b) (%)	ADS (c) (%)	Total Foreign shareholding (a+b+c) (%)
Infosys	INFO IN	555.8	36.19	3.62	13.95	53.76
Wipro	WPRO IN	1,434.6	4.89	1.08	1.53	7.50
Satyam	SCS IN	654.6	46.65	1.22	19.80	67.67

#As of September 30, '06

Source: Company data

How long does it take for the entire process to be completed?

The time lien for the current issue is quite compressed and we believe the issue will close before end of November '06. However, as shown below, in the previously sponsored ADS issues, there was almost 6-7 months difference between the date of the announcement and the pricing of the ADSs. In the current issue, the time line has been shortened since the SEC approval is not required as Infosys has been classified as a 'seasoned issuer of equities in the US'. The FIPB approval has also come in early.

Given below is the time taken by Infosys for its previously sponsored ADS issues.

Timeline for Infosys' second sponsored ADS issue (May '05)

- Date of announcement: November 5, '04
- EGM approval on December 18, '04
- Offer opening date: May 09, '05
- Offer closing date: May 19, '05
- Pricing date: May 26, '05
- Communication to shareholders regarding acceptance: June 08, '05
- Total time between announcement and pricing: almost six and half months

Timeline for Infosys' first sponsored ADS issue (July '03)

- Date of announcement: December 8, '02
- EGM approval on February 22, '03
- Offer opening date: July 16, '03
- Offer closing date: July 25, '03
- Pricing date: July 31, '03
- Communication to shareholders regarding acceptance: August 16, '03
- Total time between announcement and pricing: almost eight months

Why is promoter shareholding an important data point?

Promoter shareholding is an important data point as the acceptance is based on proportionate allotment basis i.e. proportional to the total shareholding of the offering shareholders. This means, promoters or other large shareholders will have a higher acceptance compared with other shareholders. Table 2 shows the promoter shareholdings as of September-end '06.

Table 2: Promoter holding

(%)	Dec-05	Mar-06	Jun-06	Sep-06
Infosys	19.6	19.5	19.4	19.3
Satyam	14.1	14.0	9.2	9.2
Wipro	81.7	81.4	81.1	80.9

Source: Company data

What is Infosys' current ADS premium to domestic shares? How has it been historically?

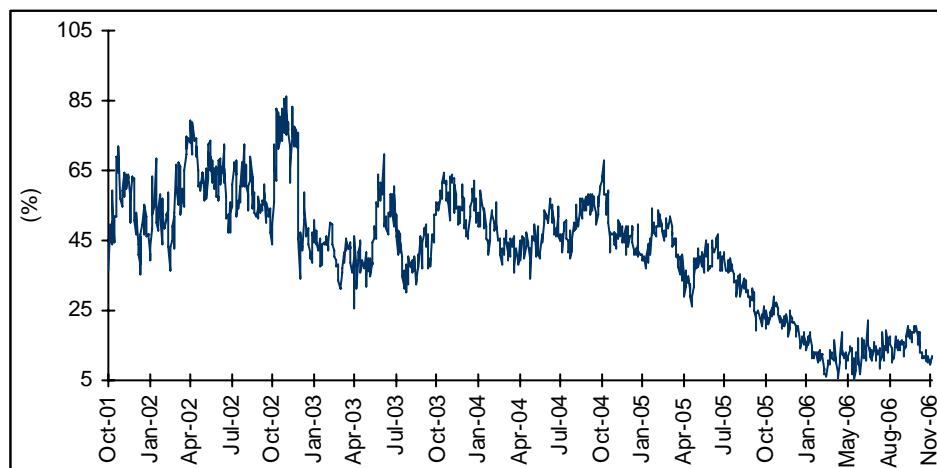
Table 3 gives the current ADS premium over domestic equity share prices and Chart 1 shows the historical ADR premium over domestic shares for Infosys. As is clear from the charts, the ADS premium has contracted for Infosys, Wipro and Satyam in the past two years. As per our understanding, the contraction in premium was mainly on account of higher FII registrations in India. This meant that investors would have sold the ADR and bought the local post getting the FII registration, thus leading to premium contraction.

Table 3: ADR premium over domestic equity prices as of November 07, '06

(%)	
Infosys	11.18
Satyam	13.40
Wipro	20.20

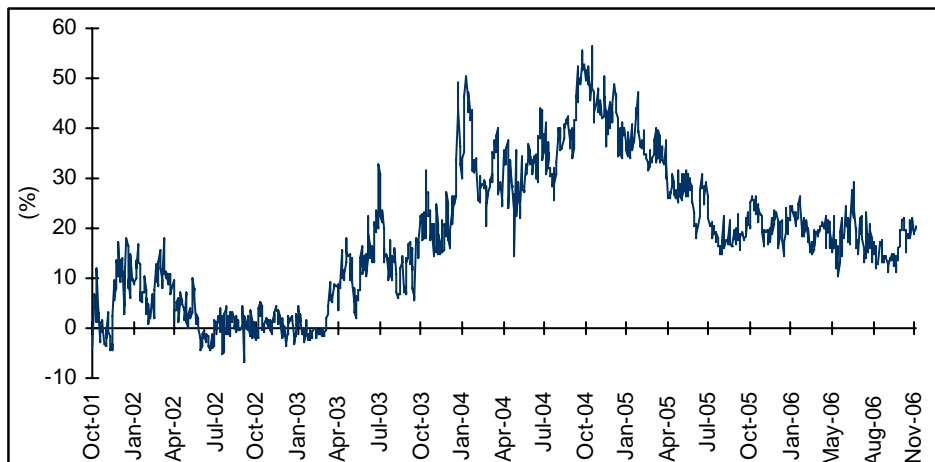
Source: i-SEC Research

Chart 1: Infosys – ADR premium to domestic share prices



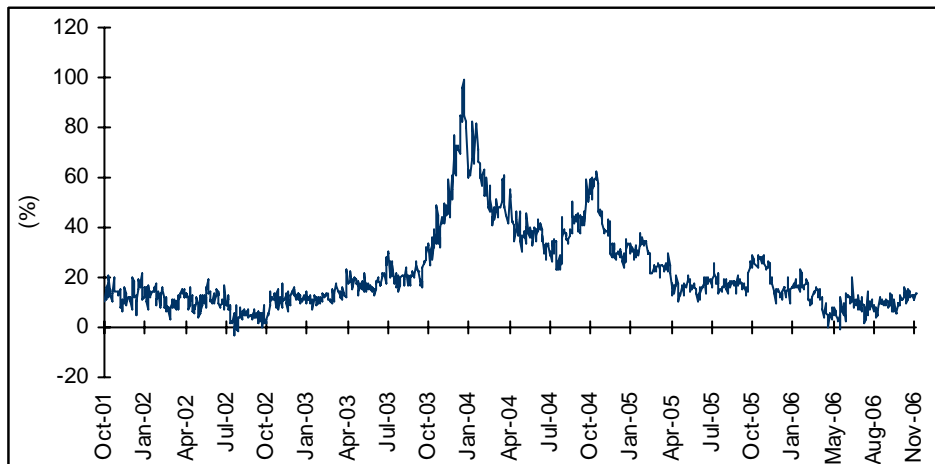
Source: Bloomberg, i-SEC Research

Chart 2: Wipro – ADR premium to domestic share prices



Source: Bloomberg, i-SEC Research

Chart 3: Satyam – ADR premium over domestic share price

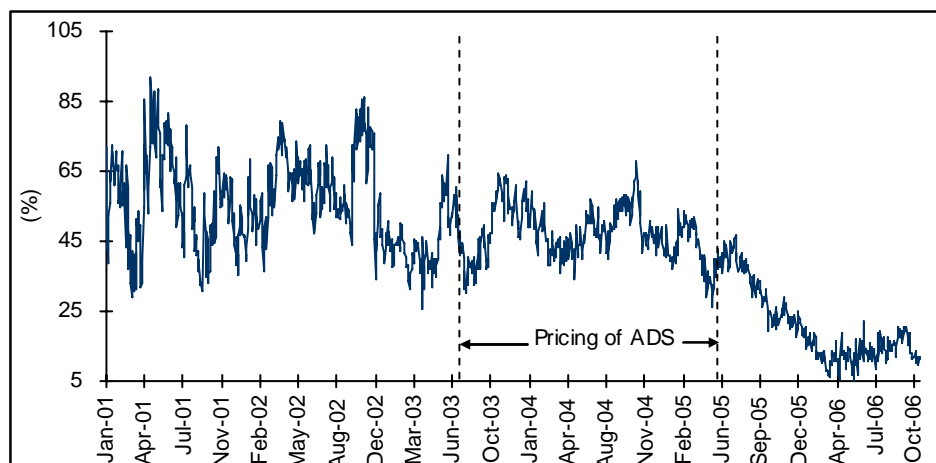


Source: Bloomberg, i-SEC Research

What was the impact on Infosys’ ADS premium during the previously sponsored ADS?

As is clear from Chart 4 and Table 4, the ADS premium shrunk around 7-8% between the date of announcement and pricing of the sponsored ADS. However, unlike the previous ADS issues, Infosys’ ADS premium this time is already very low, indicating that the magnitude of shrinkage in ADS premium might be less.

Chart 4: ADS premium over domestic price of Infosys



Source: Bloomberg

Table 4: ADS premium – Date of announcement and pricing

		Infosys ADS (US\$)	Infosys domestic (Rs)	ADS premium (%)
Date of announcement	5-Nov-04	32.79	988.1	49.9
EGM approval	18-Dec-04	34.73	1044.9	46.1
Offer opening date	9-May-05	31.56	1048.4	30.9
Offer closing date	19-May-05	32.82	1049.3	36.0
Pricing date	26-May-05	36.07	1100.7	42.6

		Infosys ADS (US\$)	Infosys domestic (Rs)	ADS premium (%)
Date of announcement	8-Dec-02	17.13	566.7	45.8
EGM approval	22-Feb-03	15.93	527.9	44.0
Offer opening date	16-Jul-03	13.63	430	46.4
Offer closing date	25-Jul-03	13.75	439.2	44.4
Pricing date	31-Jul-03	13.31	449.2	36.7

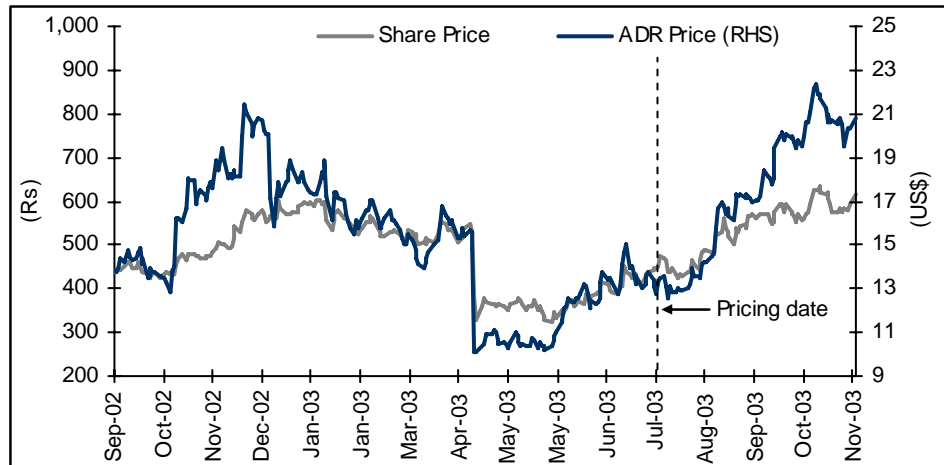
Source: i-SEC Research, Company data

What is the possible impact on Infosys' domestic share prices because of the proposed ADS issue?

In case of Infosys' previously sponsored ADS, the contraction in the ADS premium was more due to the rise in domestic prices as against the fall in ADS prices.

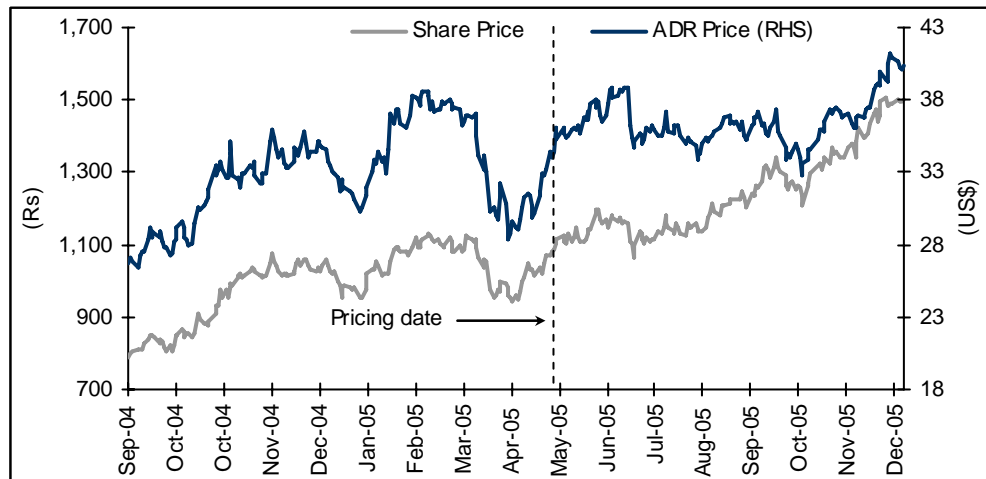
We believe, based on an extrapolation from the past, the ADS premium contraction will be caused by a rise in domestic price rather than a fall in the ADS price.

Chart 5: Domestic and ADS prices – First ADS



Source: Bloomberg, i-SEC Research

Chart 6: Domestic and ADS prices – Second ADS



Source: Bloomberg

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