INSTRUMENTS ISSUED IN AS EURO ISSUE
1 Introduction

Indian companies making an Euro issue generally resort to two types of instruments: Global Depository Receipts (GDR) and Foreign Currency Convertible Bonds (FCCB). These are the popular investment instruments in Euro issues.

**Meaning of 'GDR':** The GDR is an instrument that is in the first instance made in the form of 'Receipts' and which is based on underlying ordinary shares of the issuer company. In the expression "Global preferred to London and USA in view of the stringent disclosure requirements of securing listing in London and USA.

**No Lock-in Period:** Initially GDRs were subjected to a lock-in period of two years. This has been done away with. An investor who wants to cancel his GDR may do so by advowson the depository in lieu of shares held by the custodian. The depository will instruct the custodian about cancellation GDR and to release the corresponding shares, collect the sale proceeds and remit the same abroad.

**Marketing:** Marketing of GDR issues is done by the underwriters by organising road shows which are presentations made to potential investors. During the road shows, an indication of the investor response is obtained by an equity called the 'Book Runner. The issue fixes the range of the issue price and finally decides on the issue price after assessing the investor response at the road shows.
Increase in equity pre-determined: - In a Euro bond issue increase in equity cannot be determined and depends on the extent to which the conversion option may be exercised by the investors. But in the case of equity the issuer can determine the proceeds in advance and this enables the issuer to work out his profitability estimates accordingly.

Voting right: - The holder of the GDR is not entitled to any voting rights, so the company does not have the fear of losing the management control. The right to vote is not denied to the shareholders but is only suspended by virtue of an agreement with the depository to the effect that the GDR holders are not entitled to exercise any voting right on the GDRs held by him.

Meaning of Foreign Currency Convertible Bond
Meaning of 'bond' -- A Foreign Currency Convertible Bond (FCCB) is another instrument that is commonly issued by the Indian companies in international securities market to raise funds in foreign currencies. It is a 'bond', which indicates that it is a debt instrument that involves repayment of the principal and obligation to pay interest. In the black's Law Dictionary the word 'bond' is defined as follows:

"A certificate or evidence of a debt on which the issuing company or governmental body promises to pay the bondholders a specified amount of interest for a specified length of time, and to repay the loan on the expiration date. In every case a bond represents debt. Its holder
is a creditor of the corporation and not a part owner as is the shareholder. Commonly, bonds are secured by a mortgage."

"Foreign Currency Convertible Bonds" means bonds issued in accordance with this scheme and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments."

Nature of 'FCCB' --- The FCCB is like the convertible debentures issued in India. It has a fixed interest or coupon rate and is convertible into certain number of shares at a pre-fixed price. The bonds are listed and traded on one or more stock exchanges abroad. Till conversion the company has to pay interest on FCCBs in dollars (or in some other foreign currency) and if the conversion option is not exercised, the redemption also has to be done in foreign currency. The bonds are generally unsecured. The FCCB represents equity liked debt security which can be converted into shares or into depository receipts. The holder of the FCCBs has the option to convert it into equity normally in accordance with predetermined formula and sometimes also at a predetermined exchange rate. The holder of the FCCB also has the option to retain the bond. The FCCB, virtue of convertibility offers to issuer a privilege of lower interest cost than that of a similar non-convertible debt instruments. By issuing these bonds an company can also avoid any dilution in earnings per share that a further issue of
equity might cause whereas such a security still can be traded on the basis of underlying equity value.
2 Euro GDR/Equity Issue

The concept of GDR originated in the western capital markets in 1927. Originally GDRs were designated as instruments which enabled investors in USA to trade in securities which were not listed in the stock exchanges in USA in the form of American Depository Receipts (ADRs) till 1983. The market for ADRs was largely in investor driven and the depository banks were permitted to issue ADRs to investors even without the consent of the company. However, in 1983, the Securities Exchange Commission (SEC) made it mandatory for companies to provided for certain information for issue of ADRs. Similarly, international depository receipts were introduced in UK to enable companies in UK to trade in securities not listed in UK.

"Global depository Receipt" means any instrument in the form of a depository receipt or certificate (by whatever name it is called) created by the Overseas Depository bank outside India and issued to non-resident investors against the issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company".

One of major advantages that the GDRs offer to the issuer company is that the issue proceeds are collected in foreign currency and the same can be utilised for meeting the foreign exchange component of purchase cost, repayment of foreign currency loans, meeting overseas commitments for some other purposed. Since GDR is denominate in US dollars with the equity shares underlying each GDR denominated
in rupees, there is no exchange risk for the issuer. However a foreign investor prefers to hold GDRs in view of a number of laws relating to tax system duty, depository charges etc, involved if the GDRs are converted into shares. An investor who wants to cancel his GDRs can do so by advising the depositor who issued such a receipt in lieu of the shares held by the custodian. It can be cancelled after 45 days. The depositor instructs the custodian about the cancellation of GDR and to release the corresponding shares in the market, collect the sale proceeds and remit the same abroad.

The companies offer four types of DRs facilities i.e. Un-sponsored DRs and Sponsored DRs.

Un-sponsored DRs: These are issued by one or more depositories in response to market demand but without a formal agreement with the company. Sponsored DRs are issued by one depository appointed by the company under a deposit agreement of service contract. They offer control over the facility flexibility to list on a national exchange in the US and the ability to raise capital.

Sponsored Level - IDR are traded in the US "Over the Counter market and also on some exchanges outside the US. Under this programme the company is not required to comply with US Generally Accepted Accounting Principles (GAAP) or full Securities and Exchange Commission (SEC) disclosure requirements. Thus a Sponsored Level - IDR programme allows the company to enjoy the
benefits of a publicly traded security without changing its current reporting process.

Sponsored Level - II & III DRs: Companies that wish to either list their securities on an exchange in the US or raise capital, can use Sponsored Level-II or III Drs respectively. These DRs can also be listed on some exchanges outside the United States. Each level requires different SEC registration and reporting, as well as adherence to US GAAP. The companies are also required to meet the listing requirements of the National Stock Exchange (New York Stock Exchange/American Stock Exchange/NASDAQ).

**Negotiable instrument:** The GDR is like a negotiable instrument denominated in Dollars. A depository Receipt is rated when an investor purchases shares of a foreign company in the home stock market and the same are deposited with a custodian or a depository. The depository issues a receipt in respect of such shares. The GDRs represent securities which can be traded publicly and are issued by the Depository Banks in terms of Deposit agreement entered into with the issuer company. The GDRs represent that the underlying shares are held by the Domestic Custodian Bank and may be traded freely like any other security at the stock exchange where they are listed.

The shares are issued by the company to an intermediary called the depository, in whose name the shares are registered. It is the depository which subsequently issues the GDRs. The physical
possession of the equity shares is entrusted to another intermediary called the custodian, who is an agent of the depository. Thus while the GDR represents the issuing of a company's shares, it has distinct identity and, in fact, it does not figure in the books of the company.

The main advantage of the GDR to the issuer company is that the company is not exposed to any exchange risk, although it is able to mobilise foreign exchange by way of issue proceeds. The dividend outflow from the company is only in rupee terms, but the depository converts these rupees and pays the dividend in US dollars to the ultimate investors after deducting a withholding tax.

**Salient features of GDR:**

(i) **Right of holder:** Thus a GDR is an instrument created by an overseas depository in pursuance of an agreement between him and the Indian company which issues its equity shares that are represented by the depository receipts or (sometimes) by foreign currency convertible bonds. A GDR is denominated in dollars or in some other freely convertible foreign currency and gives its holder the right to get equity shares of the issuer company against the GDR as per the terms of the offer. Till such exchange or conversion takes place, the GDR does not carry any voting right in relation to the underlying shares. The shares are denominated in Indian rupees and they are identical to other equity shares in all respects having equal right and privileges. They do not and cannot have any extra or preferential rights or privileges.
(ii) Collections in foreign currency:- The issuer company collects the issuer proceeds in foreign currency and is thus able to utilise the same for meeting the foreign exchange component of project cost, repayment of foreign currency loans, meeting overseas commitments and for similar other purposes.

(iii) Less exchange risk:- The GDR is denominated in US dollars with the equity shares underlying in each GDR denominated in rupees. Hence, there is no exchange risk for the issuer. On the contrary, in the case of convertible bonds redemption of the non-convertible portion, if any, and payment of interest have to be made in dollar terms, making exchange risk management a vital aspect of the bond issue. Further, conversion in convertible bond issues is not automatic and the investor has the option to convert into equity or retain in as bond.

(iv) Option to hold equity shares:- The GDR gives the holder an option to convert the same into equity shares underlying it and hold equity shares instead on GDR.

(v) Listing:- The GDRs are listen at the Luxembourg stock Exchange as also traded at two other places besides the place of listing e.g. on the OTC market in London and on the private placement market in USA.
3 Euro Convertible Bonds

Foreign Currency Convertible Bonds (FCCBs) would be an approved instrument for accessing external commercial borrowing. The terms and conditions normally applicable to external commercial borrowing (such as restricting end use to import of capital goods, minimum maturity, etc.) would be applicable to FCCBs as well. Priority for access to this facility would be given to firms with a good foreign exchange earning record or potential.

A Euro bond is an international bond which is issued on behalf of a multinational corporation, international agency or sovereign State to investors from thought the world. They are normally issued as unsecured obligations of the borrowers. The instrument floated by the Indian companies are FCCBs basically equity linked debt securities to be converted into equity depository receipts after a specific period. Thus a holder of FCCBs has the option of either converting it into equity (normally at a predetermined formula and even a predetermined exchange rate), or retaining the bond. The FCCBs carry a fixed rate of interest which is lower than the rate on any other similar non-convertible debt instrument, and thus become attractive to the investors due to lower cost involved. They can be marketed conveniently and the same time the issuer company can avoid any dilution in earnings per share, unless the investors see improved earnings and prices for the shares underlying the bonds. Also they can still be traded on the basis of underlying equity value. FCCBs are
freely tradable and the issuer has no control over the transfer mechanism and is not even aware of the ultimate beneficiary.

The convertible bonds provide an opportunity too the holders to participate in the capital growth of company. Till the time the holds the bonds he gets a fixed return and in case he chooses to convert them into equity, he makes a capital gain. Thus the convertible bonds offer a mixture of the characteristics of fixed interest and equity investment. Another advantage accruing to the investor is that the bonds can be issued in a currency different from the currency in which the shares of the company are denominated. This feature enables the investors to participate in the international stock markets as well as have the option of diversifying the currency risks.

Certain variations in Euro Convertible Bonds have evolved in the past few years. These are;

Deep Discount Convertibles--- Such a bond is usually issued at a price which is 70% to 80% of its face value and the initial conversion price and the coupon rate level are lower than that of a Conventional Euro Bond; since there are no interest payments. The maturity period in some cases may extend even upto 25 years.

The equity markets have expanded rapidly during the eighties. Raising finance through equity has emerged as the cheapest way of financing in the 1990s. Moreover, the risk attached to the equity capital of companies operating in the emerging markets is relatively low as
compared to the debt. The equity instruments converted by the Indian companies are commonly termed as the GDRs i.e. Global Depository Receipts. A GDR is a negotiable instrument and is created when an investor purchases shares of a foreign company in the domestic stock market and the same is deposited with a custodian of a depository. The depository issues receipts in respect of such shares and such receipts represent a depository receipt. A GDR can be traded publicly and is issued by the depository bank in terms of deposit agreement entered into with the issuer company.
Salient features of FCCB

(i) The FCCBs are similar to convertible debenture/bond as issued in domestic capital market inasmuch as they give the holder thereof the right to convert the bond into equity shares of the issuing company.

(ii) The FCCB has a fixed rate of interest which is lower than coupons on straight bonds of comparable terms.

(iii) The conversion right stipulate that the bond holder may convert the bond into ordinary shares, either on a series of given dates or at any time between specified dates in the future. The price at which the shares may be purchased though such conversion provisions are specified at the time the bonds are issued.

(iv) The FCCBs are attractive to the issuer company because they are available to the investor at a cost less than that of the alternative fixed interest debt instruments. For the investor, these bonds offer an opportunity to participate in the capital growth of a company. He receives a fixed income from the bonds as long as he holds them but stands to make a capital gain by converting the bonds into equity, provided that by the conversion date price of the shares has risen price fails to rise or falls, the risk is limited by the income return available from the fixed interest feature of the bond.

(v) The FCCBs have the attributes of fixed interest and equity investments. They have a higher than equities but have the potential of capital gain while the risk of capital loss is limited by the ability to hold till maturity. They provide a fixed return coupled with possible capital appreciation although the price of the FCCB is more volatile
than for straight bonds being influenced by the share price of the issuing company, as well as in the international fixed interest market.

(vi) The FCCBs offer an additional advantage to the investor which is not available with domestic convertible bonds. They may be issued in a currency that differs from the currency in which the shares of the company are denominated. Such issues give the bondholders the opportunity to participate in the Japanese stock market as well as the option to diversify the currency risk.

(vii) The FCCBs are normally issued with fixed exchange rate clauses specifying the rates at which the bonds may be converted into ordinary shares of the issuer company. The investor's decision as to whether to opt for conversion or hold convertible bonds is, therefore, greatly influenced by relative exchange rate movements.
4 Zero Coupon Convertible Bonds

Zero Coupon Convertible Bond -- Zero Coupon Convertible Bond have been used mainly in US markets. These bonds are zero coupon securities issues at deep discounts to par value and mature at par value. Thus, the investor's return is the accretion to par value over the life of the instrument. The issuer escapes the periodic interest payments in gestation period of the project and yet is allowed to deduct the implied interest from taxable income.

Bulldog Bonds -- This is issue in sterling in the domestic UK market by a non UK entity.

Yankee Bonds -- Yankee Bonds are domestic US dollars issue, aimed at the US investor made by non US entity.

Samurai Bonds -- Samurai Bonds are long term, domestic yen debt issue targeted at Japanese investors and made by a non Japanese entity.

Buinny Bonds -- These bonds permit the investors to reinvest their interest income into more such bond with the same terms and conditions. Such an option to reinvest interest at the original yield is attractive to long term investors, pension funds, etc. and the companies find it as a cheap source of Finance.
Euro Rupee Bonds -- Although these bonds to not exist, several foreign institutions are considering this instrument as a means for raising finance. Denominated in Rupees, Euro Rupee Bonds can be listed in Luxembourg. Dividends will be paid in Rupee and investors will play the risk of currency fluctuation.

Dragon Bonds -- Dragon Bonds come in dollars, yen and other currencies to lure the Asian investors.
Bonds with Equity Warrants -- A derivative of Euro bonds in Bonds with Equity Warrants, which are a combination of debt, with the investor getting an option on the issuers equity. A warrant is attached to the host bond and entitles the investor to subscribe to the equity of the issuing company at predetermined price. The warrant price of shares is normally 10-15% above the share price at the time bond is issued and the warrants are exercisable on or between specified dates. Warrants are physically separate from bonds and therefore, can be detached and traded as securities. Therefore, an investor has the benefit of having two separately marketable instruments. Based on risk involved, yield, and the expectations of both issuer and the lender, there may be structural variations in these instruments.

Bull Spread Warrants -- These warrants provide an exposure to the investors to underlying shares between a lower level 'L' and an upper level 'U'. The lower level is set to pride a return above the dividend yield on the shares. After the maturity period (which is normally three years) if the share price is below the lower level 'L', the investor receives the difference from the company. On the other hand, if the issuer's share price is above the level 'U' the issuer has to pay of amount at level 'U'. In case, the stock is between 'L' and 'U' on maturity, the issuer has a choice of either paying the cash to the investor or delivering shares.
Such a variation is best suited to companies having low dividend yield since the lower level is set above the dividend yield on shares.

Money Bach Wartanis (MVWs entitle an investor to receive a certain predetermined sum from the issues provided the investor hold the warrant till it matures and it is not converted into shares. To the investor the cost of doing so is not only the cash he loses, but also the interest foregone on that sum of money. Therefore, in order to compensate, the companies must offer a higher premium than what they normally do.

Reset Warrants -- The pioneers of issuing such warrants are the Japanese companies. Reset Warrants are suitable for those stock markets where there is tremendous volatility. If a share has not performed and its market price is below the exercise price after a couple of years then the exercise option is reset to a level just above the current price; typically 2.5% above the prevailing price. However, there is a downward revision which is deeply paged at 20%
6 Other instruments

Besides the above derivatives, there are a number of debt instruments in the Euro bond market. Also there can be a number of variations, depending upon the variations in interest and/or maturity redemption period.

Euro Debt

External Commercial Borrowing (ECBs) are defined to include:

1. Commercial bank loans.
2. Buyer's credit.
3. Supplier's credit.
4. Credit from official export credit agencies.

Green Shoe Option

Green shoe option is an option to retain over subscription upto a specified amount. The option is exercised by the lead manager on behalf of the issuer. In the case of Nippon Dentro, green those of exercised to retain $125 million against an issue of $100 million. (In this case the coupon rate also crystallised at 3% against anticipated rates of 3.5% to 4%).

Conversion Option
All Euro Convertible carry this option, wherein the bond holder can exercise the option of conversion into equity. The option can be exercised after the stipulated lock in period, any time during the currency of the Bond.

**Call Option**

Call option is a valuable option retained by the Issuer. It must be understood that convertible bonds are issued with a specific stipulation as to exercise the option whereby he can compel the bond holder to convert the Bonds into equity shares. The option is generally exercised when the shares appreciate by 130% to 150%. The conditions under which the option can be exercised are predetermined.

**Put Option**

Put option is a right given to the Investor. The option can be exercised only on the put date. Only one date is stipulated. Under this option he can call upon the company, on the put date, to redden the bond. The bond holder had agreed to a low coupon rate in anticipation of appreciation and a put option is generally exercised when appreciation has eroded. To compensate the bond holder it is normally decided that differential interest should also be paid him, which is normally linked to US treasury rate plus 100 to 150 basic points. It is not necessary to give a put option. If the lead Manager is confident of placing the issue without the put option, it is avoided.
**Bloating Rate Note**

Essar Gujarat became the first company in the private sector to float FRNs in the international market. Interest on these notes would be payable every six months. For the first six months beginning, July 15, 1994, the cost of debt works out to 7.91%. These FRNs which have a maturity period of five years will be listed on the Luxembourg Stock Exchange.

IDB went in for a floating rate note (FRN) issue for raising $100 million from the Euro market on 21 June 1994 in lieu of its earlier aborted $250 million Euro-bond issue. The issue was lead managed by J P Morgan and was placed at 100 basis points over the London inter bank offered rate (Labour). Recently IFCI has also planned to come out with a Rs. 5000 crores. Floating Rate Bond (FRB) issue. This issue is underwritten and is the first FRB issue by any financial institution which is underwritten.

**Swiss Convertible Bonds**

Southern Petrochemical Inds. Corpn. floated a Euro issue of Swiss Convertible Bonds of around 90 million Swiss francs (around $80 million). This was the second issue of Swiss Convertible bonds, the first being completed by Bharat Forge during January 1994 for 20 million Swiss francs. It may be mentioned that SPIC had earlier in September 1993, raised $75 million by way of GDRs.

Recently Nicco had proposed to raise SFR 20 Million by issuing SNCs from the Swiss. Market with conversion option after a lock-in period of five years. The company had found SNCs attractive as
interest rates are low and the proposal eliminated an otherwise elaborate issue selling exercise.

However, the Government has thrown a spanner in Nicco Corporation's Swiss bond convertible (SNC) issue plans, rejecting its proposed SFR 20 million offer, at least for the present. The company has, therefore, decided to put off the issue indefinitely. The issue would have bolstered Nicco's capital base by Rs. 43 crore.

**ADR Issue**

American Depository Receipt (ADR) is a tradeable instrument, equivalent to a fixed number of shares, which is floated on overseas markets. ADR issues can be made at four levels on the preference of the company. The norms for each level differ and are based on the specific criteria to be satisfied by the issuer.

The four levels of ADR issues are as follows:

1. Level I is the most basic route under which the company issues depository receipts which are traded on the OTC exchanges abroad. Under the programme company gives a mandates to a depository use which equity analysts and other investors. The company executive interact with the investors and analysts to provide the relevant particulars about the company. Once the investors are convinced, the
investors place their orders through an overseas investment banker who contacts an Indian blocker. The local broker purchases the shares on behalf of the depository, which in return issues DRs against these shares in a pre-determined ratio. The DRs so issued are traded on the OTC exchanges overseas. A level I programme offers the following advantages to the issuer:-

(a) The company is not required to conform to Us Accounting Standard and other Sec norm necessary for listing on the New York Stock Exchanges.

(b) The shares of the company are available to all categories of investors make Euro issues where only qualified institutional buyers are permitted to invest. Even in direct investment by FIIs many of the pension funds are not invest. Even in direct investment by FIIs many of the pension funds are not permitted to invest in non dollar denominated securities.

(c) Two way fungibility is permitted in ADR ISSUES. If a foreign investor sells the DR and The Dr is converted into the underlying shares denominated in Indian rupees, a reconversion into DR is allowed.

(d) The Level IDR issue, also known as a secondary market DR issue, permits a company to broaden its investor base before marking a Euro-issue and opens up large market for the company's share.
(e) The cost of flotation of a ADR issue is quite low compared to a GDR issue -- a one time cost of about $30,000 and a recurring cost of $10,000.

2. In a Level II ADR programme listing of the DR is mandatory. The company proposing a Level II ADR issue has to conform to US accounting practices and SEC norms and satisfy certain financial and listing criteria. A non US company should have at least, shareholders and a market value of public shares of at least $100 million.

3. The Level III ADR programme also known as the non-sponsored level is for companies which have already made DR issues and the DRs are listed on one of the US exchanges. This issue is targeted at American investors.

4. The Level IV ADR programme, also known as the Restricted Area DR programme, is similar to the Level III route. In this issue, the DRs known as GDRs are offered only to qualified institutional buyers. This route for raising resources was adopted by Reliance Industries Ltd. and Grasim Industries Ltd.