

HOW TO CONVERT YOUR DEBT FINANCING TO EQUITY INVESTMENTS IN NIGERIA

INTRODUCTION

In light of recent economic realities, many companies have found it difficult to repay their debts. In order to manage this situation, companies have considered, and some have taken steps towards relieving themselves of this liability, one of which is initiating a debt conversion arrangement. This is a lifeline utilized by many companies to restructure their finances and manage their debt profile.

If as a business you have considered or are currently in the process of swapping your debts to equity, this newsletter provides some guidance for you.

A. What is a Debt-to-Equity Swap Transaction?

A debt-equity swap is a type of financial arrangement or restructuring where a company that obtained debt financing ("Debtor Company") offers its creditors an equity interest (i.e. shares) in the company in exchange for the repayment of the debt. A debtor wishing to restructure its company by offering its equity as a way of paying off its debt would have to show to the creditors that the equity is valuable upon carrying out an independent valuation of its equity.

The creditors will have to accept the offer for the restructuring to take effect.

B. What are the steps to take to give effect to a Debt-to-Equity Restructuring?

- 1. Consent of the Shareholders:** Prior to the commencement of the restructuring, it is important for the directors to obtain the consent of the shareholders, particularly as the restructuring may result in the dilution of the shares of the existing shareholders. The shareholders' approval can be signified by the execution of a resolution to this effect.

It will also be necessary to conduct a review of the Memorandum of Association and Articles of Association of the Debtor Company; and shareholders' agreement to ensure that provisions relating to the issuance and allotment of new shares are adhered to when carrying out the restructuring.

In Nigeria, under the Companies and Allied Matters Act, 2020 (CAMA) all shares of a company are required to be fully allotted. Therefore, in order to give effect to the restructuring, the shareholders will have to decide if they will relinquish some of their shares for the purpose of the restructuring or whether new shares are to be issued by the Debtor Company for the purpose of granting such shares to the creditors.

Where new shares are to be issued, the shareholders will also have to formally waive their pre-emptive rights with respect to the new shares to be issued.

- 2. Documentation:** The initial documents required for the realization of the debt-to-equity transaction will be dependent on the structure of the contemplated transaction-

- a) Where there already exists a convertible debt agreement, which states the manner in which the facility will be swapped to equity, parties are to follow the terms of such an agreement.

- b) Where however, the parties had only executed a simple facility agreement, the parties may by an addendum, amend such loan agreement to reflect the new repayment terms by the debt-equity restructuring.
- c) Where there is only a simple facility agreement as stated above, parties may also choose to enter into a debt-to-equity swap agreement without amending the original facility agreement. The debt-to-equity swap agreement will outline the terms of the swap such as, amount of debt that parties intend to convert to equity, the value of the shares to be issued, and whether such equity will be issued at a discount. The agreement should also make provisions effectively terminating the Debtor Company's liability to repay all or part of the debt after under the facility agreement such conversion.
- d) The new shareholder(s) will also be required to execute a deed of accession binding it/him to the company's existing shareholders agreement.
- e) Where the shareholders have agreed to relinquish part of their shares, they will be required to execute a share transfer form individually, transferring the required number of shares to the new shareholder.
- f) Where, however, the Debtor Company intends to create new shares to accommodate the new shareholders, the shareholders will be required to execute a resolution approving the increase in share capital to such a number as may be required to give effect to the swap. The shareholders will be required to execute appropriate resolutions allotting the new shares. The directors may also execute these resolutions where they have been authorized to do so by the shareholders.

3. Valuation of the Company: It is important while considering this debt restructuring to ascertain the value of the Debtor Company's shares at the time of the swap. In some instances, especially where there is a convertible debt agreement in existence, parties may have agreed on the value of the shares to be allotted to the creditor prior to the execution of the agreement. Where the parties did not agree on the value of the shares at the time of executing the applicable agreement, the Debtor Company is advised to conduct a valuation of its shares.

In conducting this valuation, certain factors should be considered, such as the company's financial position, the value of its assets, and the potential future performance of the company.

A proper valuation will enable the parties to determine the number of shares that should be allotted to the creditor in order to reflect the actual debt amount being converted to equity.

4. Regulatory Requirements: Following the completion of all negotiations relating to the debt-to-equity swap, the Debtor Company in compliance with the requirement of CAMA, is expected to make necessary filings at the Corporate Affairs Commission ("CAC") to register the increase in its shares and allotment of same to the creditor(s) upon paying the necessary stamp duties and filing fees. The fees and stamp duty to be paid is largely dependent on the number of shares to be registered.

It is advisable to seek counsel from your legal adviser on the best way to structure and classify the shares to avoid incurring substantial costs and to properly reflect the intent of the parties to the transaction.

- 5. Taxation:** Debt-to-equity swap transactions may also present some tax concerns that need to be considered by both parties, especially in inter-company loans. It is advisable that you work closely with your tax advisers to provide more guidance on this.

CONCLUSION

Debt-to-equity swap is a tactical restructuring tool that may help provide relief to companies with great potential, going through a rough period in business. Creditors should consider accepting this offer from companies with good potential for success if given some time and support to grow.

