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Debt Equity Swap Transactions

The question of increasing equity capital to offset debt is done by swapping or conversion. The aim of this article is to clarify the key elements to take into consideration for this type of transaction.

Introduction

A debt equity swap involves a company's creditor becoming a shareholder of the company by converting the claim or debt instrument s/he holds against the company into shares in the company.

Debt to equity financing plays a significant role in the financial landscape of Nigeria. As the nation strives for economic development, understanding the dynamics of financial activities, including the capital structure of institutions and corporations, becomes crucial.

In its simplest form, corporate debt refers to financial obligations owed by one entity to another, encompassing loans, lines of credit, secured and unsecured debt, amongst others. On the other hand, equity pertains to ownership interests, typically in the form of shares or stocks. Equity investment involves purchasing and holding shares in anticipation of returns from dividends and capital gains, granting shareholders voting and participation rights.

Debt to equity Financing: Considered Steps

Debt to equity financing arises when a creditor/investor seeks the conversion of debt instruments to equity capital with the expectation of significant returns necessitating repayment of the capital sourced. Repayment terms and conditions are typically agreed upon between the debtor and the creditor. However, if a company encounters difficulties in adhering to the initially agreed upon repayment structure, debt equity financing can provide an alternative arrangement.

In Nigeria, the procedure for debt-to-equity financing typically involves the following steps.

1. Assessment of financial situation: The debtor company must evaluate its financial position and determine if debt to equity financing is a viable solution for its repayment difficulties. This assessment includes analyzing the company's share capital and determining if it can accommodate the debt conversion.

2. Negotiation and Agreement: The debtor and creditor negotiate the terms of the debt-to-equity conversion. This includes determining the proportion of debt that will be converted into equity and any adjustments to the existing repayment structure. The terms are documented in a legally binding agreement.

3. Shareholder Approval: If the debtor company's share capital is insufficient to cover the debt, it needs approval from its shareholders to increase the share capital. Existing shareholders' right of first refusal must also be considered and adhered to with documented approval from shareholders to waive this right for the new issuance of shares to the creditor company.

4. Registration with the CAC: Once the shareholders approve the increase in Share Capital, the debtor company must register the changes with the CAC. The CAC will then update the company's records to reflect the increased share capital.

5. Debt Conversion: After completing the share increase process, the debt can be officially converted into equity. The creditor then becomes a shareholder in the debtor company and this new issuance of shares must also be registered with the CAC. The new shareholder will also now be bound by the agreed Shareholders Agreement of the debtor company thus changing the status of the erstwhile creditor to a shareholder and equity partner.

6. Regulatory Compliance: If the debt-to-equity financing involves foreign investors, additional regulatory steps are required. The issuance of a certificate of capital importation is required for foreign investment in Nigeria. This is obtained from the Central Bank of Nigeria through an authorized dealer/bank in Nigeria.

7. Tax Considerations: Throughout the debt-to-equity financing process, both parties must carefully consider the tax implications and ensure tax compliance post debt to equity conversion.

In conclusion, while debt to equity financing provides a viable option for financing companies in Nigeria, it demands careful evaluation due to its potential challenges. Contact Us to provide additional advice and evaluation of your debt-to-equity transactions.