Furore over conversion of dollar debts to equity

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Unilever, Lafarge, Guinness caught in the controversy, seek N243bn to offset dollar loans New trend signals another wave of delisting — shareholders

By Nkiruka Nnorom

THE emerging trend where some quoted companies have planned to offset their dollar denominated loans through equity conversion is raising dust among minority investors in the capital market.

Some sections of the Nigerian investor community see the move by these companies as a ploy by their foreign core investors to increase their holdings as a first step of eventual delisting from the Nigerian Stock Exchange, NSE.

This comes as Unilever Nigeria Plc, Lafarge Africa Plc and Guinness Nigeria Plc secured the nod off other sections of shareholders to raise a total of N243 billion from the existing shareholders, part of which would be used to offset their foreign debts, especially loans taken from their foreign core investors.

Lafarge Africa Plc will be raising the sum of N140 billion new equity fund from its existing shareholders, while Unilever Nigeria Plc will raise up to N63 billion through rights issue to its existing shareholders. Guinness Nigeria, on the other hand, has just opened offer for N40 billion Rights Issue.

The shareholders, who are opposed to the move, observed that the development would result to further reduction in the free float requirements of the companies which will eventually lead to voluntary or regulatory delisting due to free float deficiency. Companies quoted in the main board of the NSE are expected to maintain 20 per cent public float to remain listed.

The shareholders cited the example of Ashaka Cement Plc which recently delisted from the Exchange as a result of free float deficiency. They observed that instead of raising the money via rights issue at a time when Nigerians are battling with cash crunch and may either not take their rights at all or in full, the companies should seek other debt options to raise funds like use of commercial papers, eurobonds and preference share among others.

Background to forex losses

Recall that almost all companies in the manufacturing sector suffered huge foreign exchange losses in the wake of naira devaluation and forex unavailability that greeted the business environment in the country last year.

The introduction of a new foreign exchange policy by the Central Bank of Nigeria, CBN, in June, 2016, led to the devaluation of the official exchange rate of the Naira from N197/US$1.00 to N305.00/US$1.00 by December, 2016, while at the unofficial segment of the market, the rate hovered around N490.00/US$1.00, indicating a huge gap of about N185.00. This, in effect, almost doubled the dollar denominated debt exposure of the companies, to the creditors who, incidentally are the foreign parent companies, the core investors.

So, in order to resolve the lingering crisis, some companies have come up with the initiative of converting their dollar loans to equity, or floating Rights issue that would lead to a mop-up of the Rights of individual local investors who may be unable to pay for their Rights, thus increasing the core stakes while reducing the float portion.

Lafarge Africa Plc

Specifically, Lafarge Africa Plc will open offer for N140 billion Rights Issue in the third quarter of the year and expects to halve its FX exposure, including dollar debt used for Unicem acquisition using the proceeds of the rights issue. The company's borrowings as at end 2016 stood at N36.49 billion, while bank overdraft stood at N22.995 billion. The company had also in 2015 provided $50 million credit line to Nigeria Cement Holdings Limited to acquire initial 7.5 per cent of Unicem Limited, while in September 2015, it provided further $137 million for purchase of remaining 15 per cent of Unicem. As at the year end of 2016, Lafarge had net exchange loss of N22.7 billion and unrealised exchange loss of N5.998 billion. The foreign exchange loss of N22.7 billion arose from repayment of loans borrowed by Unicem denominated in US Dollar due to the sharp depreciation of Naira during the year.

The company, therefore, explained that it is embarking on a Rights Issue to reduce its exposure to adverse foreign currency translation losses as experienced in 2016. "The rights issue reduces our foreign currency exposure by 50 per cent. The remaining portion of the debt, with the support from LafargeHolcim, has been refinanced and hedged for 12 months", the chairman, Mr. Mobolaji Balogun, had said while providing insight on the planned offer.

He said that the size of the rights would have been inordinately large such that subscription level by the minority shareholders would be low if the company had taken the alternative step of resolving the entire foreign currency exposure with the Rights Issue. "To minimize further translation losses, we hedged $300 million with non-derivatives contracts entered into with the Central Bank of Nigeria, CBN," he added.

Unilever Nigeria Plc

Unilever Nigeria Plc is raising N63 billion through Rights Issue. As at the end of 2016, Uuilever had N20.92 billion outstanding in debt, mainly comprising N15.15 billion inter-company loan, N5.8 billion commercial bank loan and N702.7 million facility from the Bank of Industry, BoI, with 98 per cent of the outstanding debts in short term.

Of the above mentioned loan facilities, in line for conversion to equity via the proposed Rights Issue is the inter-company loan. Unilever obtained an inter-company loan of USD59.7 million (N18.81 billion) from Unilever Finance International AG in Q3-16 to clear the backlog of unpaid USD-denominated obligations to suppliers and refinance expensive local short term debts. Unilever Finance International AG is also a member of the Unilever Group. Unilever Oversea Holdings Limited (Holland) holds 50.04 per cent stake in Unilever Nigeria Plc, while Unilever Oversea BV holds 10.02 per cent in the company "In addition to the debt-equity swap, our hunch is that part of the proceeds of the Rights Issue will be utilized for the repayment of outstanding commercial bank loans (priced at 14 per cent as at end-2016), the settlement of backlogs of trade payables, as well as working capital and capital expenditure investments", analysts at Cordros Capital, a Lagos based investment house, said of Unilever's debt-equity swap.

"On the repayment of borrowings, the current option being considered by the management of Unilever can be taken for a bold attempt to guide against potential FX losses attached to the USD facility (we estimated N2.9 billion) in the event that the NGN/USD devalues to N352, the mid-point of the International Monetary Fund, IMF's suggested fair value and improve the company's deteriorating coverage and leverage ratios. We expect total debt will be reduced from N20.92 billion to only the N702.7 million due to the BoI, potentially driving down interest expense to a record low of N70 million", Cordros Capital added.

Guinness Nigeria Plc

Guinness Nigeria, which has obtained all the regulatory approval, is raising N39.7 billion via Rights Issues. One of the objectives of the exercise, according to the company, is to deleverage its balance sheet given its relatively high debt level. Diageo Plc, the core investor in the company, plans to take up its rights by way of a debt/equity swap where the outstanding foreign currency loan of USD95 million loan as at end of 2016 (N20.3 billion as at H1'17) will be used as payment for its rights in Guinness. Diageo Plc holds 54.32 per cent of the company's shares.

In the event of an under-subscription, the parent companies would have the opportunity to take-up the rights of other shareholders who did not participate in the offer. This will automatically increase the core holdings while decreasing the float.

Shareholders' reaction

In his reaction, Amb. Olufemi Timothy, President, Renaissance Shareholders Association, RSA, speaking on behalf of the association's members, said that in a recession and with the kind of foreign exchange Nigeria has today, foreign investors are at advantage.

He stated: "The foreign investors bring in few dollars to pick their Rights in Naira, while Nigerians don't have cash now to take up their Rights. So, at the end of the day, the foreign core investors in these companies will just take over all the shares of the local investors. As a result of this, the foreign investors will have up to 80 – 85 per cent of the company's shares, then the company will be short of the public float of 20 per cent and then ask for delisting.

"Lafarge Africa is coming for a Rights Issue and it has French core investor. Unilever is coming for Rights Issues and it has foreign investors, same for Guinness. So, what will happen at the end of the day, the foreign investors will take over the local investors and in the end, they will delist." he said.

Most of the companies are going out of the stock exchange. So, in a recession like this, Rights Issue is not the best if you have the interest of the domestic investors at heart. I don't know why the regulators don't think this way; that allowing and advising companies to raise capital through Rights Issue is not the best", Timothy stated. "Unilever is owing the core investor N15 billion; Lafarge is trying to convert N140 billion loan and the core investors is already holding 74 per cent equity stake, while the local investors are holding 26 per cent. So, if they do Rights Issue now, the foreign investors will pick more," he emphasised.

Corroborating the earlier view, Patrick Ajudua, National Chairman, New Dimension Shareholders, said: "Our fear is that minority interest is not being taken care of. Of course, if there is a Rights Issue, there is specific number of shares to be acquired by the foreign core investors, but on our part, some of us do not have the money to take up our Rights. So, the foreign core investors will mop up those unclaimed Rights, thereby increasing their stake in the company at the detriment of the minority shareholders.

According to him, the Rights Circulars may not get to the minority shareholders until the conclusion of the exercise. Even the Annual Reports are not sent to people on time because of postal problem and even problems from the companies themselves that usually fail to dispatch the documents timely as required by law. Also speaking, Igbrude Moses, National Secretary, Independent Shareholders Association of Nigeria, ISAN, said that instead of debt-equity swap, the core investors should buy their Rights like other minority shareholders, while part of the funds realised would be used to offset the debt.

"When the foreign core investors granted the dollar loans to the companies, it was business transaction to which interest on the loans were supposed to be paid. Now, there is devaluation and they want to convert those debts to equity. At what rate are they going to do the conversion? It will be to their advantage," he stated. He explained that Nigerian minority shareholders' fear stemmed from the fact that most foreign core investors would over shoot the required percentage holding in event that the minority shareholders fail to fully take up their Rights and eventually ask for delisting.

Though some of the companies have allayed our fears, but we have seen cases where after getting more than the required percentage of shareholding, the majority shareholder opted for delisting. He advised the NSE to come up with rule that would bar foreign core investors in quoted companies from acquiring above certain percentage of shareholding in their companies.

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