

# Private equity transactions in Nigeria: some legal considerations

by Seyi Ogunro, Banwo & Ighodalo

NIGERIA IS THE SECOND LARGEST ECONOMY IN SUB-SAHARAN AFRICA (SSA), WITH ITS PRIVATE EQUITY (PE) SECTOR ACCOUNTING FOR ABOUT 10% OF THE REGION'S PE CAPITAL. THE TARGET SECTORS FOR MOST PRIVATE EQUITY FUNDS (PEFs/FUNDS) INCLUDE TELECOMMUNICATIONS, INFORMATION AND COMMUNICATIONS TECHNOLOGY, MINING, REAL ESTATE AND CONSTRUCTION, OIL AND GAS, FINANCIAL SERVICES, MEDIA AND ENTERTAINMENT, SHIPPING, FOOD AND AGRO-ALLIED PRODUCTS ETC. OPPORTUNITIES FOR INVESTING IN THESE SECTORS HAVE MAINLY ARISEN AS A RESULT OF BROAD SECTOR REFORMS AND IMPROVED FISCAL DISCIPLINE, MORE BUSINESS FRIENDLY AND FAVOURABLE POLICIES (INCLUDING DEREGULATION AND PRIVATISATION), AVAILABILITY OF TAX INCENTIVES FOR EXPORT-ORIENTED BUSINESSES AND THE EFFORTS OF GOVERNMENT TOWARDS CREATING A MORE ENABLING BUSINESS ENVIRONMENT.

PE investment in Nigeria takes place in both start-up and established businesses. The common investment strategies include venture capital, buyouts and restructuring (provision of growth capital). Venture capital provides equity funding to younger, small and relatively high-risk companies with strong growth potential, while buyouts and restructurings on the other hand, deal with more mature firms where substantial gains in operational efficiency are likely to materialise. Some of the major players in the Nigerian PE market are African Capital Alliance, Actis, Vectis, Emerging Capital Partners (ECP), Ethos and Travant.

The most common legal structure for PEFs investing in Nigerian entities<sup>1</sup> is the limited partnership, consisting of at least one general partner (usually the Fund Manager) whose liability for all the debts and obligations of the Fund is unlimited, and other limited partners who are investors



Seyi Ogunro

Associate

Banwo & Ighodalo

tel: +234 (80) 3041 4835 (mobile)

e-mail: [sogunro@banwo-ighodalo.com](mailto:sogunro@banwo-ighodalo.com)

in the Fund, but are not liable for the debts and obligations of the Fund beyond their respective contributions. The Fund Manager manages the Fund's business while the Fund's investors as limited partners do not participate in the day-to-day management of the business, but many receive certain investment approved rights under the terms of their constituting documents.

Nonetheless, in Nigeria, registration as a limited partnership is available only in Lagos State, although, once registered, a limited partnership can carry on business anywhere in the country. However, if the name of the Fund does not include any of the names of the Fund's promoters, the Companies and Allied Matters Act Cap C20, Laws of the Federation of Nigeria (LFN) 2004 (CAMA) provides that the name of the Fund must also be registered as a Business Name under part B of CAMA at the Corporate Affairs Commission (CAC). Despite the fact that there is an existing legal regime for the establishment and management of limited partnerships in Nigeria, most PEFs promoted by Nigerian entities are established outside Nigeria, in offshore jurisdictions like Mauritius, British Virgin Islands and the Cayman Islands.<sup>2</sup>

PEFs in Nigeria usually obtain funding from institutional investors, such as insurance companies, financial institutions, high net worth individuals (mostly sophisticated investors) and independent PE firms.

Typically PEFs investing in Nigeria usually hold onto their investments for about three to five years before exit and seek a domineering role in the management of the investment. Exit strategies from such investments include initial public offerings, offers for sale, secondary-buyouts, trade sales, acquisition by initial sponsors or a majority shareholder interest, to mention a few.

## Private equity deals in Nigeria

Unlike the US and other advanced economies where PE deals mainly consist of leveraged buyouts, the predominant forms of PE deals in Nigeria are management buyouts and restructuring, including jumpstarting green or brown field investments. Actis has been a key player in most

Nigerian private equity deals; notable ones include its US\$134m investment in Diamond Bank Nigeria Plc, and other investments in UAC of Nigeria Plc, Starcomms Nigeria Plc (Starcomms) and the Palms Shopping Mall, from which it has successfully divested. Noteworthy also are ECP's investment in Notore Chemical Industries Limited, Intercontinental Bank Plc and Starcomms; African Capital Alliance's successful investment in MTN Nigeria Communications Limited, the Associated Bus Company Plc, a transportation company, Cornerstone Insurance Plc and Linkserve Limited;<sup>3</sup> and Ethos' US\$130m investment in Oceanic Bank International Plc.

## Some legal considerations for private equity funds investing in Nigeria

Although there is no specific regulation on the establishment, management and operation of PEs in Nigeria, depending on the transaction and, more importantly, on whether the investment is in a public or private entity, there are a number of transaction specific rules that must be complied with. It is therefore imperative that the Fund Manager is acquainted with the specific laws to be applicable at each stage of any PE financing.

### Raising funds from local investors

PEFs may on a one-on-one basis solicit investments from target local investors such as high net-worth individuals, banks, insurance companies and pension funds. However, the Banks and other Financial Institutions Act Cap B3, LFN 2004 (BOFIA), the Insurance Act Cap I17, LFN 2004 and the National Pension Commission's Regulation on Investment of Pension Fund Assets (Pension Regulations) significantly regulate the investment powers of Nigerian banks, insurance companies and pension funds.

The BOFIA prevents banks from acquiring or holding any part of the share capital of any financial, commercial or other undertaking, subject to certain exceptions. Upon obtaining the approval of the Central Bank of Nigeria (CBN), banks can invest in any company set up to promote the development of the Nigerian money and capital markets

or improve the financial machinery for financing economic development. Pursuant to subsisting CBN Regulations, banks can also acquire shares in small and medium-scale industries, agricultural enterprises and venture capital companies subject to the condition that such investment does not at any time exceed 20% of the bank's shareholders funds and not more than 40% of the investee company's paid up share capital.

The Insurance Act regulates the capacity of insurance companies to invest in Nigeria by stipulating that insurance funds must be invested and held in Nigeria in certain kinds of permitted investments. Although the Act and issued regulations do not specifically prohibit Nigerian insurance companies from investing in PEFs, nor are they listed among permitted investments, in reality, insurance companies have significant PE investments. Insurance company investments are however required to be disclosed in periodic returns filed with the insurance industry regulator, the National Insurance Commission.

Under the Pension Regulations, even though PE is not expressly mentioned as a permitted investment, a pension fund's assets can be invested in the investment certificates of closed-end investment funds or hybrid-investment funds if the same is *inter alia* listed on a securities exchange registered under the Investments and Securities Act No.29 of 2007 (ISA). Since a PEF can be structured as a closed-end or hybrid investment fund, then by implication, pension funds in Nigeria may invest in funds that are listed on any securities exchange registered under the ISA.

### Acquisition of shares and or other securities in investee companies

In structuring a private equity transaction, one of the first tasks of the Fund Manager is identifying an investee company. The nature of the Funds' investment in the investee company could be equity, debt, convertible debt or even a combination of two or more of these types of investments.

Equity investment makes it easier for the Fund to control and monitor the activities of the investee company since the Fund's equity will entitle it to vote at the general meeting of the company and usually participate on the board. The parties may enter into an Equity Purchase

Agreement (EPA) to outline the terms and conditions for acquiring the investee company's shares and upon such acquisition, the Fund must ensure that its name is entered in the investee company's register of members. A common provision in the EPA is the delivery of share certificates by the investee company to the PEF. Where the investment is a private investment in a public entity (PIPE), then attention must be paid to provisions on the delivery of share certificates. This is because the parties must take into consideration recent steps by the Nigerian Stock Exchange (NSE) to fully dematerialise share certificates of investors holding shares in companies listed on the exchange, through its clearing house, the Central Securities Clearing Systems Limited (CSCS). Shareholders are expected to open CSCS accounts through a stockbroker registered with the Securities and Exchange Commission (SEC) and obtain a CSCS Clearing House Identification Number.

Apart from just being entitled to vote at the general meeting, the Fund will also seek to protect its stake as a shareholder of the company. It could, by way of a Shareholders' Agreement where the investment is a private one, or a Subscription Agreement where the investment is a PIPE, ensure that there are share transfer restrictions and anti-dilution provisions. For example, rights of first refusal, rights of first offer, tag-along and drag-along rights. It is imperative that the Shareholders' Agreement does not contravene the provisions of the articles of association of the investee company, the CAMA and or any other applicable Nigerian laws or regulations.

In order to ensure maximum returns on its investment, the Fund will naturally be interested in the good governance and management of the investee company. The Fund would thus ensure that the powers of directors to manage the company are exercised in good faith and in the fund's interests. Accordingly, the Fund would require that the Shareholders' Agreement provides that it has powers to appoint directors, thereby assuring its representation on the board of the investee company, especially on committees such as the finance and audit committees. It should be noted that this could pose a problem of conflict of interest as under the CAMA the board of the investee company is expected to act in the best interests of the company and not the Fund.

The Fund may also engage in Loan Investments. One of the advantages of loan investment by the Fund is a reduction on tax liability arising from the investment. This is because the interest payments that form a return on the Fund's investment will be deducted from the investee company's earnings before tax. Further, the Companies Income Tax Act Cap C21, LFN 2004 (CITA) grants significant tax exemptions (up to 100% depending on the tenor of the loan, including moratorium and grace period) on interest payments on foreign loans.

### Investment in Nigeria by foreign private equity funds (FPEFs)

Foreign investors are permitted to make investments in Nigerian securities, whether in the primary or secondary markets, or by private placements. Such foreign investments are mainly regulated by the Nigerian Investment Promotion Commission Act Cap N117, LFN 2004 and the Foreign Exchange (Monitoring and Miscellaneous Provisions) Act Cap F34, LFN 2004. Both Acts provide for the liberalisation of foreign direct investment in Nigeria and permit foreign investors who intend to invest in Nigerian enterprises to do so without having to seek approvals from numerous regulators. As with any foreign investor, a foreign PEF (FPEF) – i.e., a Fund established outside Nigeria – is guaranteed the unconditional transferability of dividend and interest on foreign loans, as well as capital repatriation in the event of liquidation or divestment. Upon importation of funds for investment in Nigeria, a foreign investor is entitled to receive from an authorised dealer through which the funds were imported (usually a licensed bank), a Certificate of Capital Importation (CCI) evincing the amount of capital imported into Nigeria to be invested in the Nigerian company. The CCI enables the PEF to repatriate the proceeds of its Nigerian investments without restriction, net of applicable taxes. The investee company is obliged by the CITA to withhold tax at the rate of 10% as final tax on such proceeds at source (that is, dividend in the case of equity investment and interest in the case of loans), before remitting the same to the PEF.<sup>4</sup>

Under the ISA, only securities of public companies are registered by the SEC or traded on the primary or secondary markets. Thus, while a FPEF does not require

SEC notification before making investments in Nigerian private companies, portfolio investments in securities of companies listed on the stock exchange must be notified to the SEC and made through SEC-registered capital market operators or licensed brokers and/or dealers.

### Exit strategies

In Nigeria, some of the common forms of divestment for PEFs are a trade sale, an offer for sale and an initial public offering.

The Fund may engage in a trade sale i.e., the sale of the investee company's shares to another portfolio company; or in an offer for sale i.e., an invitation by the PEF as an investor or shareholder to members of the public to apply for new or existing shares in the company. Also, where the articles of association of the investee company provide for pre-emptive rights or other constituting documents in favour of other shareholders, the fund may sell its shares to other existing shareholders. The manner in which the sale would be done would depend on the type of company and the terms prescribed in the company's articles of association.

With respect to its investment in private investee companies, the Fund may sell its equity holdings to third parties who may be existing shareholders. If the disposal is made at a profit, the profit will not be subject to Capital Gains Tax (CGT). The reason for this is that CGT on the sale of shares has been abolished in Nigeria. Upon the sale, the names of the new shareholders will be entered in the company's register of members.

Where the investment is a PIPE, the SEC rules provide that a foreign investor shall divest its holdings in securities in public companies through the Nigerian Stock Exchange or on a recognised over-the-counter market with respect to shares traded on that market. Divestment of holdings in securities in any other public company shall be done through capital market operators. These operators are required to notify the SEC of the particulars of the divestment by the foreign investor within five working days of the divestment.

The Fund could also exit from private investee companies through an initial public offering (IPO). IPOs are extensively regulated by the SEC. It would be necessary to convert the

investee company into a public company before the IPO is undertaken. The NSE listing rules require that the company should apply in the prescribed form for listing of its shares on the NSE. Before making the application, certain requirements must be complied with. At least 25% of the share capital of the company having a nominal value of at least N250,000 shall be made available to the public; the number of shareholders must not be less than 300 unless otherwise approved by the Council of the NSE; and the securities must be fully paid up at the time of allotment.

## Conclusion

Apart from the quality of commercial decisions, the undertaking of feasibility studies of proposed target sectors and due diligence on investee companies, the success of any PEF transaction depends on a significant number of legal and governance issues under a number of regulatory regimes. PEFs must ensure that there is compliance with the laws of the place of incorporation as well as the jurisdiction where they intend to invest.

Although Nigeria's private equity sector is not yet as vibrant as those of advanced economies, there is no doubt that the economic reforms have made the environment attractive to PEFs. The global economic downturn has certainly caused a decline in financial activities and as resilient as African markets may seem to be, they too have been affected, even though they have generally fared better than their counterparts in Europe and the Americas. The sources from which PEFs active in Nigeria, obtain

funding, have not escaped the financial meltdown. With this in mind, it is foreseeable that even though there may not be a halt in private equity transactions, there will be a decrease during the current global economic downturn in the volume of deals, as PEFs struggle to obtain funding. Nevertheless, Nigeria still holds very good prospects for investments given its large untapped resources, growth potential and substantial infrastructure requirements. It is hoped that, as private equity transactions increase and the benefits (where well and equitably structured) become clearer, an even more conducive legal and tax environment will be created for the operations and establishment of PEFs in Nigeria.

### Notes:

1. PEFs established in Nigeria can also be structured as private limited liability companies and private trusts.
2. The primary reason for this is to ensure tax efficiency.
3. The Linkserve transaction was one of the earliest for Capital Alliance and it provided a steep learning curve.
4. Investors from countries who share a Double Taxation Treaty with Nigeria enjoy a WHT reduction of 7.5% or less.

### Contact us:

#### Banwo & Ighodalo

98, Awolowo Road, South-West Ikoyi 101232, Lagos,  
NIGERIA

tel: +234 (1) 461 5203-4; 463 0853-4; 270 2657

fax: +234 (1) 461 5205; 270 2658

web: [www.banwo-ighodalo.com](http://www.banwo-ighodalo.com)

e-mail: [banwigho@banwo-ighodalo.com](mailto:banwigho@banwo-ighodalo.com)