ÆLEX

DEPOSITARY RECEIPTS: A TOOL FOR INVESTMENT IN SUB-SAHARAN AFRICA

HANNATU DAN-HABU

Hannatu is an Associate and a member of the firm's Capital Markets and Banking & Finance Practice Groups

hdan-habu@aelex.com

INTRODUCTION

The perception about African economies appears to be changing as investors are increasingly taking an interest in participating in Africa's capital markets through the use of Depositary Receipts (DRs).

An analysis of a series of surveys of several manufacturing firms around the developing world shows that at the margin, capital investment had a higher return in Africa. Nigeria, for example, has a debt-to-GDP ratio[1] of only about 21 per cent, compared with countries like Italy and Japan whose debt-to-GDP ratio is more than 100 per cent.[2] According to a World Bank report,[3] foreign investors get a higher return on their African investments than those in other regions.

Although several companies interested in Africa have tried to manage their African businesses from Europe or the Middle East, this has not proven to be successful as variance in culture, currency, legal systems, tax administration, regulatory climate and language have made this management difficult. However, it appears that the use of DRs can help overcome these limits and allow for the free flow of funds within the international capital market.

What are Depositary Receipts?

DRs are negotiable certificates of debt or equity which can be traded on a foreign stock exchange and issued by an overseas depository bank to foreign investors. These securities are initially issued by an 'issuing company' (i.e. a local company listed on a stock exchange) to an overseas depository bank who acts as an intermediary between the investors and the issuing company. The security is registered in the name of the depository bank who then issues the DRs to investors.

---

[1] Debt-to-GDP ratio is the ratio between a country's debt to its gross domestic product (GDP). It is an indicator of an economy's health; a high debt-to-GDP ratio indicates too much debt.
[2] Trading Economics 'Nigeria Government Debt to GDP' (2018) <https://tradingeconomics.com/nigeria/government-debt-to-gdp>
[3] Makhtar Diop, Yuan Li, Li Yong and H.E. Ato Ahmed Shide, 'Africa Still Poised to Become the Next Great Investment Destination' (2015) http://www.worldbank.org/en/news/opinion/2015/06/30/africa-still-poised-to-become-the-next-great-investment-destination

In essence, a local company can trade its shares in the international markets by issuing a DR to investors. For example, let us consider '***NewCo***', a Nigerian company listed on the Nigeria stock exchange that is seeking additional capital for a new project and wants to access foreign investors. NewCo can achieve this by listing its securities on a foreign stock exchange by issuing DRs. Even though NewCo is a Nigerian company, investors in other countries can trade the Newco's securities through these DRs.

Benefits of Issuing Depositary Receipts

As shown above, a DR program is a useful option for companies listed on a stock exchange seeking to expand their equity base outside their home market further. Thus, a company trying to raise capital may use a DR as a capital-raising tool to access capital overseas.

Using DRs, companies from more than 80 countries have been able to access new investors outside their home markets.[4] The associated advantages of a DR listing typically include higher stock prices, higher investor demand and share liquidity in line with international trends.

Because a DR is a tool that can be used to access the foreign market, a company that issues a DR increases its chances of global visibility and boosts its reputation in the local market.

DRs also play a critical role in different types of cross-border transactions, such as privatisations, mergers and acquisitions, corporate actions, and strategic issuer objectives. Among the variety of methods used in the privatisation process all over the world, DR offerings are reported to be particularly attractive and represent a large proportion of successful privatisations.[5] In 1990, Telefonos de Chile, the government-owned telephone company in Chile was privatised through the use of American Depository Receipts. This move was widely described as "the first important pathway for

---

[4] JPMorgan 'Depositary Receipts- Reference guide' (2005) <http://quantlabs.net/academy/download/free_quant_instituitional_books_/%5BJP%20Morgan%5D%20Depositary%20Receipts%20Reference%20Guide.pdf>

[5] Kateřina Holická 'International Financing – Focused on GDR and ADR'(2004) Univerzita Karlova v Praze Fakulta sociálních věd <file:///C:/Users/hdan-habu.AELEXPARTNERS/OneDrive%20-%20AELEX/Downloads/444_katerina_holicka.pdf>

developing countries to directly tap Western capital markets."[6] Other countries[7] have subsequently used DRs to generate privatisation revenues.

Companies may issue DRs to achieve specific corporate objectives. For example, a company may develop employee share schemes for employees outside the issuer's home market in a bid to facilitate a convenient investment vehicle for such employees.

Companies that participate in DRs can encourage foreign investment without worrying about barriers to entry investors might face such as, variances in currency, language barriers and unstable regulations.

Global Depositary Receipts (GDRs) and American Depository Receipt (ADRs)

While the DR programs can be structured in a variety of ways, there are two basic options that are being utilised and these are American Depositary Receipt programs and the Global Depositary Receipt programs.

Using the American Depositary Receipt (ADR), American institutional investors (pension funds, life offices and unit/investment trusts) hold and trade the shares of overseas companies. The ADR makes it easier for non-US issuers to sell and for Americans to buy, own and trade equity.

DRs traded on stock exchanges in other parts of the world are known as, 'Global Depository Receipts' (GDRs). The Global Depository Receipt (GDR) is a type of depository receipt listed in a foreign stock market, usually on European stock exchanges such as the Deutsche Börse or London stock exchange, and cleared through the Euromarket clearing systems. The use of GDRs has risen by more than 8% between 2004

---

[6] William L. Megginson, Jeffry M. Netter and Candra S. Chahyadi, 'Size and Impact of Privatisation – A Survey of Empirical Studies' <https://www.cesifo-group.de/DocDL/dicereport105-forum1.pdf>

[7] Examples include Pakistan, Poland and Hungary

and 2005 alone.[8] For instance in 2007, Russia's second-largest bank, Vneshtorgbank traded its DRs on London Stock Exchange that raised US$8 billion.[9]

In some respects, the GDR and ADR are similar. Both are financial and negotiable instruments, and holders of both instruments are entitled to equity benefits such as dividends, bonus shares and rights issues. They are usually quoted in US dollars, though the underlying shares are denominated in local currency. In both cases, a custodian issues ADRs/GDRs to subscribers and acts as an agent of the depository in whose name the shares are registered.

Depositary Receipts (DR) vs Foreign Direct Investment (FDI)

DR and Foreign Direct Investment (FDI) are similar in that they both involve a foreign entity investing in a business operation in another country. An FDI is when a person has equity participation in a foreign company. Through FDIs, investors directly enter the overseas market, thus exposing their investments to risks prevalent in overseas markets such as foreign exchange instability, changing local legal and tax regimes, uncertain regulatory changes, and expropriation.

On the other hand, DR transactions tend to have comparably lower associated costs. Using DRs, foreign investors can buy the shares of the issuer in their own country, thus avoiding any risks they may face if they make direct investments in a foreign country.

Depositary Receipts from Africa and Nigeria

Even though there are 54 countries and more than 1.2 billion people in Africa, the vast majority of African DRs are from South Africa.[10] Except for a few Nigerian and Zambian stocks, there is not a lot of African presence in foreign stock exchanges.

---

[8] "In 2004 – 2005, GDRs were used to raise 40% of all capital, compared to 27% in the comparable 2001 – 2003 timeframe." <http://quantlabs.net/academy/download/free_quant_instituitional_books_/%5BJP%20Morgan%5D%20Depositary%20Receipts%20Reference%20Guide.pdf>

[9] Privatisation Barometer, The PB Report 2007

[10] Javier Hasse, 'Why Most African Companies Are Not Listed On The NYSE Or Nasdaq: It's All About Valuations' (2017) < https://www.benzinga.com/news/17/02/9095772/why-most-african-companies-are-not-listed-on-the-nyse-or-nasdaq-its-all-about-val>

Some Nigerian banks have successfully issued DRs. For instance, Guaranty Trust Bank Plc was the first African bank to have its GDR listed on the London Stock Exchange (LSE) [11] and its listing was subscribed to a tune of $750 million.[12] In 2008, Diamond Bank PLC raised $500 million on the London Stock Exchange after it listed its GDRs.[13] Zenith Bank PLC also listed its GDR on the Irish Stock Exchange (ISE) in 2017 and it recorded 300% oversubscription.[14]

With continued globalisation, investors who seek to diversify their portfolios globally[15] may purchase DRs. Investors who invest in DRs emanating from sub-Saharan countries would not have to deal with any barriers to entry they may face if they enter the market directly, such as variances in currency, language barriers and uncertain legal and regulatory climate.

The Important Bit: The Offering Circular

To run a successful DR program, it will be expedient for the issuing company to appoint advisors with the requisite expertise. The function of the advisor includes preparing exchange listing agreements and drafting a comprehensive prospectus (also known as the ***offering circular***).

An offering circular is a disclosure document, drafted by an issuing company and presented to investors for their capital[16]. An offering circular can be the significant difference between a company getting capital or going unnoticed by investors. The offering circular will serve as a guide to the investor, and as such, the preparation of the

---

[11] 635 by GTBank, “GTBank Marks the 10th Anniversary of Listing on the London Stock Exchange” (2017) <https://635.gtbank.com/2017/07/gtbank-marks-the-10th-anniversary-of-listing-on-the-london-stock-exchange/>

[12] Daily Trust “GTB Lists $750 Million Offer On LSE” (2007) <https://allafrica.com/stories/200707091017.html>

[13] Proshare, “Diamond bank listed on London Stock Exchange” <https://www.proshareng.com/news/Investors%20NewsBeat/Diamond-Bank-Listed-on-London-Stock-Exchange/3439>

[14] Vanguard, "Zenith Bank's $500m Eurobond records 300% oversubscription." <https://www.vanguardngr.com/2017/06/zenith-banks-500m-eurobond-records-300-oversubscription/>

[15] Friedland Capital Inc. ‘Guide To American Depositary Receipts’ (2005) <https://www.karlschempp.com/documents/guidetoadrs.pdf>

offering circular is of utmost importance and will remain integral to the long-term development of the DR program.

In Nigeria, GDRs represent underlying shares which may be admitted on the Nigeria Stock Exchange (NSE) as part of the issued share capital of the Company. Where the GDR is to raise capital, the Issuer is required to file the following information with the Securities and Exchange Commission (SEC):

- Capital history of the issuer (e.g. total share capital, paid-up, issued and un-issued capital) with evidence of an increase in share capital (where applicable);
- Currency in which securities for the programme would be denominated (e.g. dollars, pound sterling, or Naira);
- Evidence that the Central Bank of Nigeria (CBN) has cleared the plan.[17]
- Evidence of clearance by other regulatory agencies would be required where applicable.
- A signed copy of audited accounts for the preceding three (3) years which shall not be more than nine (9) months old. Where the latest audited accounts are more than nine months old, recent interim audited statements for the first six (6) months of the financial year must be included.
- Rights and obligations attached to each class of securities if different classes of securities are being issued.

In a circular dated 3rd December 2007, the CBN published the following guidelines on the issuance of CCIs for GDR transactions:

[17] The Central Bank of Nigeria is responsible for the issuance of Certificates of Capital Importation (CCI) A CCI is statutory evidence of capital inflow/investment into a Nigerian company. It facilitates the payment of dividends and capital to the foreign investor

- Where the foreign exchange inflow is in respect of GDR, a Master Certificate of Capital Importation (CCI) should be issued in favour of the Depository Bank to the tune of the foreign exchange inflow.
- Upon issuance of the master CCI, the receiving bank/Authorised Dealer should furnish the CBN with a copy with the details of the beneficial investors to the GDR endorsed on the back of the master CCI.
- Where any portion of the GDR is cancelled offshore by the investor, the Depository Bank, shall inform the custodian/sub-custodian of the Master CCI of the cancellation and provide the latter with the necessary documentary evidence of same.
- The Depository's nominee custodian shall have valid CCI covering the number of shares withdrawn from the GDR and also effect a "markdown" of the CCI from the master CCI.

With the valid CCI covering the number of shares withdrawn from the GDR, the direct non-resident equity investor can trade with the underlying shares in the local market.

Conclusion

As mentioned above, some of the advantages a company could have when it initiates a DR program include, accessing new investors outside their home markets, increased chances of global visibility and a boost in its reputation in the local market.

While DRs are an excellent way to raise capital outside the issuer's home market or to make equity more widely accessible, companies interested in launching DR programs should seek professional advice from experienced lawyers, bankers and stockbrokers, in relation to the manner the offering circular should be presented and how the DRs will be held and transacted.

ÆLEX is a full-service commercial and dispute resolution firm. It is one of the largest law firms in West Africa with offices in Lagos, Port Harcourt and Abuja in Nigeria and Accra, Ghana.

Contact us at:
4th Floor, Marble House,
1 Kingsway Road, Falomo Ikoyi,
Lagos, Nigeria
Telephone: (+234-1) 4617321-3, 2793367-8, 7406533,
E-mail: lagos@aelex.com
To see our other office locations, please click **HERE**
www.aelex.com

You may also visit our social media pages: