Ahead of Next Bond Auction

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

12.75% APR 2023	9.20%
12.50% MAR 2035	11.70%
12.98% MAR 2050	12.60%

Amount:

12.75% APR 2023	63.37bn
12.50% MAR 2035	68.73bn
12.98% MAR 2050	160.10bn

SUMMARY OF CURRENT AUCTION

FGN APR 2023

Auction Date	17/06/2020
Settlement Date	19/06/2020
Maturity Date	27/04/2023
Next Coupon Date	27/10/2020
Clean Price	110.58

FGN MAR 2035

Auction Date	17/06/2020
Settlement Date	19/06/2020
Maturity Date	27/03/2035
Next Coupon Date	27/09/2020
Clean Price	108.48

FGN MAR 2050

Auction Date	17/06/2020
Settlement Date	19/06/2020
Maturity Date	27/04/2050
Next Coupon Date	27/09/2020
Clean Price	102.91

FGN Bond Auction Scheduled 17th June 2020

Issue on Offer/Summary

The Federal Government of Nigeria (FGN), through the Debt Management Office (DMO), will be conducting a bond auction on Wednesday 17th of June 2020. The total amount on offer is expected to fall within the range of NGN135bn to NGN165bn. All three (3) instruments on offer are re-opening issues.

12.75% FGN APR 2023	**NGN40bn**
12.50% FGN MAR 2035	**NGN50bn**
12.98% FGN MAR 2050	**NGN60bn**

Current Yield Analysis

Investor participation at Primary Market Auctions in recent sessions have expectedly remained strong, given the dearth of low risk investment options amid high system liquidity, and the limitations on the repatriation of funds by foreign investors. At the last Primary Market Auction (PMA), strong investor participation was reflected by high bid-to-cover ratios of 1.22x, 2.24x and 1.18x on the offered instruments.

In the secondary bond market, buying pressure has prevailed since the last auction with the average yield dropping by 39bps to 9.98% as at the 15th of June 2020. This was fueled by a relatively higher liquidity in the system, as more assets filter in following the OMO maturity of NGN461.49bn in the period.

In what appears like a second wave of the deadly coronavirus outbreak, China has recently recorded a sudden spike in new cases. This leading to the closure of Beijing in a bid to contain the spread. This development has started reversing the gains, that followed the production cut agreement of OPEC+, as crude-oil price is now below the USD40 per barrel mark. On the domestic front, although activities are beginning to gather momentum as the government continues to relax the lockdown measures in place, the number of confirmed cases has been on the rise. Thus, investors have remained jittery, opting for low-risk investments.

In the currency market, the uptick in oil prices has incited some accretion to the reserves and abated some of the pressure on the currency, reducing the possibility of a further devaluation. However, this could be short-lived by another wave of COVID-19.

As mentioned earlier, demand for instruments in the market has remained strong, as the dearth of low risk investment options takes its toll on the capital market. One of such cases, is the level of traction gained by the recent FGN Sukuk Bond which saw a subscription of NGN669.12bn as against the NGN150bn on offer. Considering the high level of subscription and the low level of allotment, we expect the demand and liquidity to be diverted to this auction.

Please refer to page 5 for our disclaimer notice and other relevant disclosures

Bond Absolute and Relative Valuation

Valuing the 12.75% FGN APR 2023, and 12.50% FGN MAR 2035 and 12.98% FGN MAR 2050 re-opening offers with the current yield curve as the basis for discounting, we arrived at the following fair value, implied yield and an IRR for the instruments:

Instrument	Fair Value	Implied Yield	IRR
12.75% FGN APR 2023	112.46	8.49%	4.33%

Instrument	Fair Value	Implied Yield	IRR
12.50%FGN MAR 2035	111.37	11.30%	5.66%

Instrument	Fair Value	Implied Yield	IRR
12.98% FGN MAR 2050	105.91	12.60%	6.13%

Our valuation gives a fair-trading price ex coupon payment, the expected return on the bond considering its periodic interest payments and the expected return on the bond's periodic payments. We analysed the issues on offer given the current yield environment, market liquidity, as well as a review of the recent past auctions, whilst also introducing market sentiment factor into our valuation, on which we advise bid yield ranges for both issues on offer

About Bonds

A bond is a fixed income debt instrument issued by the government (federal or state government) or corporate institutions with a definite date of maturity and a fixed interest payment (known as coupon) payable either semi-annually or annually. Unlike equities, bonds are issued with a guarantee of the initial investment and can have tenors as long as 20 years.

A treasury note refers to a government bond instrument with a term to maturity of 1 to 10 years while a treasury bond has a maturity of 10 years and above. Bonds issued by state governments of a country are referred to as municipal bonds while those issued by organizations are corporate bonds.

The government usually issue bonds at the primary market to raise domestic funds to meet its fiscal responsibilities. This can be done from time to time as the need arises. Nigerian FGN bond instruments are named by their maturity, coupon, tenor etc. such as 13.05% FGN AUG 2016 instrument.

How is Return Determined?

Bonds are mostly issued with a coupon otherwise known as **the periodic interest payable**. Bond instruments are usually issued at par; that is, N100 or N1,000 as is the case with Nigerian bonds. A 2-year bond issued at 12% annual coupon with a par value of N1000 implies that the issuer will make 3 semi-annual payments of N60, and a final N1060 on the maturity date.

Bonds can be purchased at both the primary and secondary markets, they are either quoted in price or yields. **There is an inverse relationship between the price of a bond and its yield to maturity (YTM).** At issuance, the yield on a bond instrument is most likely the coupon on that instrument. At the secondary market therefore, an investor can trade bonds by quoting a yield that reflects the variance between the par value and the current price based on the current market dynamics.

How does the Auction Process work?

Bond instruments are issued through a competitive bidding process at auctions as conducted by the Debt Management Office which serves as the representative of the government. An existing government instrument can be re-issued also at the primary market in which case the DMO re-issues based on the current market yield to maturity.

Bonds are auctioned at established rates which determine the return to investors.

Purchasing these instruments in the primary market and holding it till maturity would mean that the investor gets a fixed interest payment, however, there is a secondary market in which investors can trade these bonds to meet their immediate liquidity needs.

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