Ahead of Next Bond Auction

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

12.50% JAN 2026	6.00%
12.50% MAR 2035	8.52%
9.80% JUL 2045	8.90%
12.98% MAR 2050	8.94%

Amount:

12.50% JAN 2026	NGN66.97bn
12.50% MAR 2035	NGN25.43bn
9.80% JUL 2045	NGN6.81bn
12.98% MAR 2050	NGN4.60bn

SUMMARY OF CURRENT AUCTION

FGN MAR 2035

Auction Date	21/10/2020
Settlement Date	23/10/2020
Maturity Date	27/03/2035
Next Coupon Date	27/03/2021
Clean Price	171.26

FGN JUL 2045

Auction Date	21/10/2020
Settlement Date	23/10/2020
Maturity Date	24/07/2045
Next Coupon Date	24/01/2021
Clean Price	117.42

FGN Bond Auction Scheduled for 21st October 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 21st of October 2020. The total amount on offer is expected to amount to NGN30bn. Both instruments on offer are re-opening issues.

12.50% FGN MAR 2035	**NGN15bn**
9.80% FGN JUL 2045	**NGN15bn**

Current Yield Analysis

Buying interests remained strong at the last Primary Market Auction (PMA) held in September 2020. The DMO's NGN150bn offering was oversubscribed by 240% after attracting about NGN360bn in total subscription. Bid to cover ratios of 1.25x, 2.81x, 6.03x and 35.64x across the instruments on offer (**12.50% JAN 2026**, **12.50% MAR 2035**, **9.80% JUL 2045** and **12.98% MAR 2050**) reveals that investors' preference was skewed towards the longer tenured instruments. Marginal rates also declined across board to 6.00%, 8.52%, 8.90% and 8.94% from 6.70%, 9.35%, 9.75% and 9.90% respectively on the 2026s, 2035s, 2045s and 2050s.

In the Treasury Bonds secondary market, bullish sentiment continued to dominate, evinced by the 248bps dip in average bond yield to 4.89%, from 7.37% as at the last auction). Significant demand brought about by excess liquidity in the system – owing to inflows from OMO maturities and bond coupon payments have largely influenced the market's direction. In addition, the paucity of attractive alternatives and rotational placement by foreign investors unable to repatriate their funds, have also contributed to the bullish momentum.

In the global space, in what appears like a second wave of the deadly coronavirus outbreak, the US and certain European countries such as France, Spain, Portugal and Italy have recorded a sudden spike in the daily new infection cases. In response, France has imposed curfews and restrictions on public gathering while Portugal has declared a state of calamity. Should the situation worsen, we may see more widespread lockdown measures and a gradual halt in economic activities as we had during the first wave of infections.

On the domestic front, headline inflation for September 2020 continued its ascent, climbing by 49bps to 13.71%. This sets real rate of return deeper in the negative territory and should ordinarily discourage market participation. More so, renewed interest in equities which has seen the local bourse advance significantly over the past weeks (*YTD return of 6.77%*) suggests that investors might consider equities considering the depressed yield environment, thus limiting participation. Nonetheless, we expect to see robust subscription at upcoming auctions, as the scarcity of alternatives, amid robust system liquidity persists.

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

Bond Absolute and Relative Valuation

In valuing the **12.50% FGN MAR 2035**, and **9.80% FGN JUL 2045** 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
12.50% FGN MAR 2035	171.26	5.35%	2.68%
9.80% FGN JUL 2045	117.42	8.15%	4.08%

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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