MERISTEM

Ahead of Next Bond Auction

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

12.50% JAN 2026	11.65%
16.2499% MAR 2037	13.10%

Amount:

12.50% JAN 2026	NGN14.18bn
16.2499% MAR 2037	NGN84.61bn

SUMMARY OF CURRENT AUCTION

FGN JAN 2026

Auction Date	19/01/2022
Settlement Date	21/01/2022
Maturity Date	22/01/2026
Next Coupon Date	22/01/2022
Clean Price	103.23

FGN JAN 2042

Auction Date	19/01/2022
Settlement Date	21/01/2022
Maturity Date	21/01/2042
Next Coupon Date	21/07/2022
Clean Price	100

FGN Bond Auction Scheduled for 19th January 2022

Issue on Offer/Summary

The Federal Government of Nigeria (FGN), through the Debt Management Office (DMO), will be conducting a bond auction on Wednesday 19th of January 2022. The total amount on offer is expected to be between NGN140bn and NGN160bn from two issues. One of the issues (the Jan 2026 instrument) is a re-opening issue, while the other (the Jan 2042 instrument) is a new issue.

12.50% FGN JAN 2026	**NGN70bn – NGN80bn**
FGN JAN 2042	**NGN70bn – NGN80bn**

Current Yield Analysis

At the last Primary Market Auction (PMA) held in December 2021, there was a decline in investors' participation as overall subscription reduced by 50.36% MoM. This was despite the oversubscription on the 2026 and 2037 instruments (bid to cover ratio: 1.82x and 1.26x respectively). While marginal rates on the 2026s remained constant at 11.65%, that of the 2037s increased to 13.10% from 12.95%.

Against the backdrop of negative real returns and weak macro fundamentals, FGN bond investors have been demanding higher rates as observed in the direction of range of bids. Near-term outlook is uncertain however, rates may tick up albeit marginally on the long end. Our position is supported by the FGN's large budget deficit and the government plans to increasingly look to the domestic debt market to plug its budget deficit over the medium term. The new instrument (2042s) on offer will likely attract significant investor interest given the potential for capital gains. This may however lead to a low offer yield.

In the secondary market, activity level was relatively lower in December 2021 relative to November 2021 level. Market turnover fell by 48.31% over the period. It was a generally bearish market during the period as average bond yield increased to 10.92% from 10.76%. So far in January 2022, a generally bullish trend has been observed as average bond yield declined to 10.51% (as of 17th January 2022), from the December 2022 average (of 10.92%). Although the outlook for yields remains uncertain, we think the current bullish sentiment will persist over the near term despite negative real rate return.

Please see the table below for our recommended bid rates based on our analysis of the current yield environment.

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

Bond Absolute and Relative Valuation

In valuing the **12.50% FGN JAN 2026** and **FGN JAN 2042** offers with the current yield curve as the basis for discounting, we arrived at the following fair value, implied yield and advised bid rates for the instruments:

Instrument	Fair Value	Implied Yield	Advised Bid Rates
12.50% FGN JAN 2026	103.23	11.47%	11.45% - 11.80%
FGN JAN 2042	100	12.85%	12.85% - 13.00%

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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