MERISTEM

Ahead of Next Bond Auction

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

12.50% JAN 2026	11.6500%
16.2499% APR 2037	12.9500%
12.98% MAR 2050	13.2000%

Amount:

12.50% JAN 2026	NGN44.80bn
16.2499% APR 2037	NGN52.72bn
12.98% MAR 2050	NGN95.24bn

SUMMARY OF CURRENT AUCTION

FGN JAN 2026

Auction Date	17/11/2021
Settlement Date	19/11/2021
Maturity Date	22/01/2026
Next Coupon Date	22/01/2022
Clean Price	103.30

FGN APR 2037

Auction Date	17/11/2021
Settlement Date	19/11/2021
Maturity Date	18/04/2037
Next Coupon Date	18/04/2022
Clean Price	121.86

FGN MAR 2050

Auction Date	17/11/2021
Settlement Date	19/11/2021
Maturity Date	27/03/2050
Next Coupon Date	27/03/2022
Clean Price	98.70

FGN Bond Auction Scheduled for 17th November 2021

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 November 2021. The indicated total amount to be on offer is NGN150bn. All instruments on offer are re-opening issues.

12.50% FGN JAN 2026	**NGN50bn**
16.2499% FGN APR 2037	**NGN50bn**
12.98% FGN MAR 2050	**NGN50bn**

Current Yield Analysis

At the last Primary Market Auction (PMA) held in October 2021, there was a decline in investors' participation as overall subscription slowed by 25.01% MoM. This was despite the oversubscription on the 2037 and 2050 instruments (bid to cover ratio: 1.05x and 1.90x respectively). We note the increase in marginal rate on the 2050 instrument by 40bps to 13.20% (from the rate in August 2021). We opine that this increase in rate was in a bid to attract investors.

While the inflation trajectory presents room for increase in rates as real returns remain negative (inflation rate of 15.99% in October 2021), we express concern over Government's willingness to increase rates given its already high debt service burden. More so, we note the FGN's increased appetite for external loans in a bid to reduce its borrowing costs, as the National Lawmakers recently approved USD16.23bn and EUR1.02mn loan requests. Overall, we expect strong investors' participation, considering the increase in liquidity stemming from the maturing NGN72.50bn OMO bills this week.

Activity levels in the secondary market has been relatively quiet. Since the last auction date, average bond yield dropped marginally by 1bp to 10.66% on 16th November 2021. With relatively fewer alternatives, we expect bearish sentiments to prevail in the secondary market given the expected strong investor participation at the PMA.

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**, **16.2499% FGN APR 2037** 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 advised bid rates for the instruments:

Instrument	Fair Value	Implied Yield	Advised Bid Rates
12.50% FGN JAN 2026	103.30	11.47%	11.30% - 11.60%
16.2499% FGN APR 2037	121.86	12.94%	12.80% - 13.00%
12.98% FGN MAR 2050	98.70	13.15%	13.05% - 13.25%

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 the 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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