MERISTEM

Ahead of Next Bond Auction

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

12.50% JAN 2026	10.95%
13.00% JAN 2042	13.00%

Amount:

12.50% JAN 2026	NGN103.47bn
13.00% JAN 2042	NGN193.92bn

SUMMARY OF CURRENT AUCTION

FGN JAN 2026

Auction Date	21/03/2022
Settlement Date	23/03/2022
Maturity Date	22/01/2026
Next Coupon Date	22/07/2022
Clean Price	107.41

FGN JAN 2042

Auction Date	21/03/2022
Settlement Date	23/03/2022
Maturity Date	21/01/2042
Next Coupon Date	21/07/2022
Clean Price	109.00

FGN Bond Auction Scheduled for 21st March 2022

Issue on Offer/Summary

The Federal Government of Nigeria (FGN), through the Debt Management Office (DMO), will be conducting a bond auction on Monday, 21st of March 2022. The total amount on offer is between NGN140bn and NGN160bn from the two issues. The two instruments (**JAN 2026** and **JAN 2042**) are re-opening issues.

12.50% FGN JAN 2026	**NGN70bn – NGN80bn**
13.00% FGN JAN 2042	**NGN70bn – NGN80bn**

Current Yield Analysis

Since the beginning of 2022, the dynamics of the Nigerian fixed income market has continually been influenced by the same factor: high system liquidity. Thus, the demand for treasury instruments has been strong, with total subscription increasing by 71.48% MoM (to NGN557.71bn) at the Primary Market Auction (PMA) held in February. Also, the high subscription level propped the Debt Management Office (DMO) to raise NGN297.39bn (1.98x the amount offered). However, increased allotment at the February PMA led to a lower bid to cover ratio of 1.88x (vs. 1.91x at the January PMA). Further to the robust demand, marginal rates on both instruments declined to 10.95% and 13.00% (vs. 11.50% and 13.10% at the previous auction).

In the coming auction, we do not expect a different play in the market. While inflation has recently resumed an uptick due to the scarcity of petroleum products, we think that investors' bargaining power to demand higher rates is low. Our view is further supported by the recent successful Eurobond issuance of USD1.25bn priced at 8.375% at the International Capital Market. We think that the Federal Government would further tap into the highly liquid global markets ahead of any significant rates hike by monetary authorities in advanced markets. This will continue to lower the ability of local investors to demand higher rates. Thus, we expect rates to trend lower in the coming auction.

The declining rates in the Primary Market Auction has also been filtering into the secondary market. Bond yields have maintained a downtrend since the last auction, with average bond yield at 9.15% as of 16th of March (104bps below the yield as at the previous auction). Until there is a change in yield direction at the PMA, we do not expect a reversal of the bullish trend in the near term.

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

Bond Absolute and Relative Valuation

In valuing the **12.50% FGN JAN 2026** and **13.00% 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	107.41	10.11%	10.10% - 10.65%
13.00% FGN JAN 2042	109.00	11.81%	12.60% - 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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