MERISTEM

Ahead of Next Bond Auction

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

13.53% MAR 2025	10.10%
12.50% APR 2032	12.50%
13.00% JAN 2042	13.15%

Amount:

13.53% MAR 2025	NGN79.59bn
12.50% APR 2032	NGN39.91bn
13.00% JAN 2042	NGN106.62bn

SUMMARY OF CURRENT AUCTION

FGN MAR 2025

Auction Date	18/07/2022
Settlement Date	20/07/2022
Maturity Date	23/03/2025
Next Coupon Date	23/09/2022
Clean Price	108.03

FGN APR 2032

Auction Date	18/07/2022
Settlement Date	20/07/2022
Maturity Date	27/04/2032
Next Coupon Date	27/10/2022
Clean Price	103.95

FGN JAN 2042

Auction Date	18/07/2022
Settlement Date	20/07/2022
Maturity Date	21/01/2042
Next Coupon Date	21/07/2022
Clean Price	98.82

FGN Bond Auction Scheduled for 18th July 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 18th of July 2022. The total amount on offer is expected to be between NGN210bn and NGN240bn from three issues. The instruments include three re-opening issues (Mar 2025, Apr 2032, and Jan 2042).

13.53% FGN MAR 2025	**NGN70bn – NGN80bn**
12.50% FGN APR 2032	**NGN70bn – NGN80bn**
13.00% FGN JAN 2042	**NGN70bn – NGN80bn**

Current Yield Analysis

At the last Primary Market Auction (PMA) held in June 2022, there was a decline in demand for instruments on offer (especially on the Apr 2032 instrument). The total subscription at the auction was 4.04% lower than the prior auction (NGN552.36bn vs NGN575.63bn in May). Also, the lesser subscription level impacted the decision of the Debt Management Office (DMO) to raise a lower amount NGN226.12bn (vs NGN345.26bn in May). Notwithstanding the decline in both subscription and allotment levels, bid to cover ratio increased to 2.44x (vs. 1.67x at the May PMA), mainly resulting from the significant decline in amount allotted (-34.51% MoM). Particularly for the Apr 2032 instrument, we note that the lower demand was met with a lower allotment compared to the prior auction (NGN39.91bn was allotted in June vs NGN85.34bn in May). Thus, bid to cover ratio on the instrument increased to 2.11x (vs.1.35x May). Overall, marginal rate on the trio instruments increased by 10bps, 5bps and 15bps to 10.10%, 12.50%, and 13.15% respectively.

In the coming auction, we anticipate an increase in rates across tenors. We expect this to be supported by the increase in Monetary Policy Rate (MPR) by the Central Bank, as well as an expectation for further rate hikes. Also, the Government's focus on domestic financing to fund its budget deficit and the spiraling inflation (which has kept real rate of return in the negative) supports the argument to increase rates. We note that there was a surge in rate at the last Treasury Bills Primary Market Auction which attests to the demand for higher rates by investors. On the flip side, Central Bank's Ways and Means of financing the Government could serve as a reason to keep rates low.

Bearish sentiments dominated the secondary market as average bond yield increased by 22bps to 11.41% (as of 14th July), from 11.19% as at the last auction date. We expect the bearish sentiment to continue to prevail in the secondary market given the current lower system liquidity and the expectation of an increase in rates at the PMA.

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

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 **13.53% FGN MAR 2025, 12.50% FGN APR 2032** 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
13.53% FGN MAR 2025	108.03	10.02%	10.20% - 10.95%
12.50% FGN APR 2032	103.95	11.80%	12.50% - 12.80%
13.00% FGN JAN 2042	98.82	13.17%	13.15% - 13.30%

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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