FGN Bond Auction Scheduled for November 14th 2022

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

14.45% APR 2029	14.50%
12.50% APR 2032	15.00%
16.25% APR 2037	16.00%

Amount:

14.45% APR 2029	NGN3.13bn
12.50% APR 2032	NGN11.90bn
16.25% APR 2037	NGN92.85bn

SUMMARY OF CURRENT AUCTION

FGN APR 2029

Auction Date	14/11/2022
Settlement Date	16/11/2022
Maturity Date	26/04/2029
Next Coupon Date	26/04/2023
Clean Price	99.48

FGN APR 2032

Auction Date	14/11/2022
Settlement Date	16/11/2022
Maturity Date	27/04/2032
Next Coupon Date	27/04/2023
Clean Price	89.16

FGN APR 2037

Auction Date	14/11/2022
Settlement Date	16/11/2022
Maturity Date	18/04/2037
Next Coupon Date	18/04/2023
Clean Price	101.92

Issue on Offer/Summary

The Federal Government of Nigeria (FGN), through the Debt Management Office (DMO), will be conducting a bond auction on Monday, November 14th 2022. The total amount on offer is expected to be between NGN210bn and NGN240bn from three issues. The instruments include three re-opening issues (APR 2029, APR 2032, and APR 2037).

14.55% FGN APR 2029	**NGN70bn – NGN80bn**
12.50% FGN APR 2032	**NGN70bn – NGN80bn**
16.25% FGN APR 2037	**NGN70bn – NGN80bn**

Current Yield Analysis

At the last Primary Market Auction (PMA) held in October, demand for the instruments on offer declined significantly relative to the auction held in September. The total subscription at the auction dropped by 51.64% MoM to NGN119.18bn (vs. NGN246.44bn at the September PMA). The low subscription rate impacted the total amount allotted, which plunged by 52.93% MoM to NGN107.88bn (vs. NGN229.20bn at the previous auction). We attribute the reduction in subscription levels to the tighter financial conditions spurred by the aggressive hawkish Monetary Policy stance. The recent hiking of key policy rate and Cash Reserve Ratio to 15.50% and 32.50%, respectively, mopped up system liquidity as the interbank treasury rate increased by 514bps to 12.21% between 27th September (MPC decision date) and October PMA. Despite the decline in subscription and allotment, the bid-to-cover ratio improved to 1.10x (vs 1.08x in September), attributable to the substantial drop in the amount allotted. Cumulatively, marginal rates on the APR 2032 and APR 2037 increased by 115bps and 150bps to 15.00% and 16.00%, respectively.

In the coming auction, we anticipate a marginal increase in rates across tenors. This is based on investors' demand for higher rates to compensate for the persistent increase in inflation (20.77% YoY in September - the highest in over a decade), which has impacted real return. Also, the expectation of a further hike in the monetary policy rate (MPR) could influence investors' decisions to demand more advanced rates. Overall, we expect investors' participation at the auction to remain minimal.

The sentiment in the secondary market has been largely bearish since the previous primary market auction, with an average bond yield of 14.44% as of November 10th (69bps higher than the last auction date). We expect the bearish sentiment at the secondary market to persist in the near term, owing to the tighter system liquidity and the increase in the rate at the primary market auction.

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 **14.55% FGN APR 2029, 12.50% FGN APR 2032** and **16.25% FGN APR 2037** 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
14.55% FGN APR 2029	99.48	14.67%	14.78% - 15.05%
12.50% FGN APR 2032	89.16	14.65%	14.90% - 15.15%
16.25% FGN APR 2037	101.92	15.90%	15.95% - 16.23%

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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