Ahead of Next Bond Auction

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

14.55% APR 2029	14.75%
12.50% APR 2032	15.20%
16.25% APR 2037	16.20%

Amount:

14.55% APR 2029	NGN25.13bn
12.50% APR 2032	NGN27.12bn
16.25% APR 2037	NGN216.91bn

SUMMARY OF CURRENT AUCTION

FGN APR 2029

Auction Date	12/12/2022
Settlement Date	14/12/2022
Maturity Date	26/04/2029
Next Coupon Date	26/04/2023
Clean Price	99.99

FGN APR 2032

Auction Date	12/12/2022
Settlement Date	14/12/2022
Maturity Date	27/04/2032
Next Coupon Date	27/04/2023
Clean Price	89.13

FGN APR 2037

Auction Date	12/12/2022
Settlement Date	14/12/2022
Maturity Date	18/04/2037
Next Coupon Date	18/04/2023
Clean Price	101.34

FGN Bond Auction Scheduled for 12th December 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, 12th December 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 Primary Market Auction (PMA) held in November, demand for the instruments increased significantly compared to the auction in October. Specifically, November's total subscription (NGN344bn) more than doubled October's figure (NGN119.18bn). The increase in subscriptions was primarily driven by the robust system liquidity, owing to the coupon payments (NGN189.52bn) at the end of October. Similarly, the total allotment increased by 149.50% MoM to NGN269.16bn (vs NGN107.88bn at the previous auction). As such, the total bid-to-cover ratio was 1.28x (vs 1.10x in October), signifying higher investor demand for the FGN bonds at the PMA. The investors' demand, especially for higher incentives to reflect the current market realities, influenced the Government's decision to offer higher rates at the auction. Consequently, the marginal rates on the trio instruments increased by 25bps, 20bps, and 20bps to 14.75%, 15.20% and 16.20%, respectively.

In the forthcoming auction, we anticipate a marginal decline in rates on the instruments. This is primarily premised on robust system liquidity – *evinced by lower average interbank rates (13.88% vs 15.58% as at the last auction)* – that could prompt higher demand for the instruments. Taking a cue from the latest Nigerian Treasury Bills auction, a notable spike in demand for the instruments forced a moderation in the stop rates across all instruments. Also, we consider the Government's effort to manage its borrowing costs as a factor that supports our expectation.

In the secondary market, the sentiment has mainly been bullish since the previous auction, with an average bond yield of 14.09% as of 9th December (38bps lower than the last auction date). For the rest of the year, we expect the sentiment to persist owing to continued buying activities from investors – especially those unable to get the instruments 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 **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	99.99	14.54%	14.50% - 14.70%
12.50% FGN APR 2032	89.13	14.66%	14.95% - 15.20%
16.25% FGN APR 2037	101.34	16.00%	15.95% - 16.15%

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. In addition, we analysed the issues on offer given the current yield environment and 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.

Contact Information

Brokerage and Retail Services	
topeoludimu@meristemng.com	(+234 905 569 0627)
contact@meristemng.com	
Investment Banking/Corporate Finance	
rasakisalawu@meristemng.com	(+234 806 022 9889)
seunlijofi@meristemng.com	(+234 808 536 5766)
Wealth Management	
funmilolaadekola-daramola@meristemng.com	(+234 805 498 4522)
crmwealth@meristemng.com	
Tel: +234 01 738 9948	
Registrars	
oluseyiowoturo@meristemregistrars.com	(+234 802 321 0561)
martinaosague@meristemregistrars.com	(+234 802 303 1783)
www.meristemregistrars.com	
Tel: +23401-280 9250	
Trust Services	
damilolahassan@meristemng.com	(+234 803 613 9123)
trustees@meristemng.com	
Group Business Development	
saheedbashir@mersitemng.com	(+234 802 454 6575)
ifeomaanyanwu@meristemng.com	(+234 802 394 2967)
info@meristemng.com	
Client Services	
adefemitaiwo@meristemng.com	(+234 803 694 3034)
car@meristemng.com	
Finance	
olasokomubo@meristemfinance.com	(+234 803 324 7996)
matthewawotundun@meristemfinance.com	(+234 802 390 6249)
Investment Research	
damilareojo@meristemng.com	(+234 816 890 2771)
praiseihansekhien@meristemng.com	(+234 817 007 1512)
research@meristemng.com	

Corporate websites: www.meristemng.com www.meristemwealth.com www.meristemregistrars.com

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