MERISTEM

Ahead of Next Bond Auction

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

13.98% FEB 2028	14.10%
12.50% APR 2032	14.90%
16.25% APR 2037	15.69%
14.80% APR 2049	15.80%

Amount:

13.98% FEB 2028	NGN61.91bn
12.50% APR 2032	NGN9.39bn
13.00% JAN 2042	NGN53.16bn
12.98% MAR 2050	NGN243.69bn

SUMMARY OF CURRENT AUCTION

FGN APR 2029

Auction Date	19/06/2023
Settlement Date	21/06/2023
Maturity Date	23/04/2029
Next Coupon Date	23/10/2023
Clean Price	102.54

FGN JUN 2033

Auction Date	19/06/2023
Settlement Date	21/06/2023
Maturity Date	21/06/2033
Next Coupon Date	21/12/2023
Clean Price	N/A

FGN JUN 2038

Auction Date	19/06/2023
Settlement Date	21/06/2023
Maturity Date	21/06/2038
Next Coupon Date	21/12/2023
Clean Price	N/A

FGN JUN 2053

Auction Date	19/06/2023
Settlement Date	21/06/2023
Maturity Date	23/06/2053
Next Coupon Date	23/06/2023
Clean Price	N/A

FGN Bond Auction Scheduled for 19th June 2023

Issue on Offer/Summary

The Federal Government of Nigeria (FGN), through the Debt Management Office (DMO), will be conducting a bond auction on Monday, June 19, 2023. The total amount on offer is expected to be between NGN320bn and NGN400bn from four issues. The instruments include one re-opening issue (APR 2029) and three new issues (JUN 2033, JUN 2038, and JUN 2053).

14.55% FGN APR 2029	**NGN80bn – NGN100bn**
FGN JUN 2033	**NGN80bn – NGN100bn**
FGN JUN 2038	**NGN80bn – NGN100bn**
FGN JUN 2053	**NGN80bn – NGN100bn**

Current Yield Analysis

At the last Primary Market Auction (PMA) held in May, demand for the offered instruments increased marginally relative to the auction held in April. The total subscription was higher by 7.86% MoM than the previous auction (NGN478.92bn vs NGN444.03bn at the PMA in April). We attribute the increased subscription level to the robust system liquidity (NGN701.24bn vs a negative value of NGN345.80bn at the previous auction). Nonetheless, total allotment declined slightly by 0.14% MoM to NGN368.16bn (vs NGN368.67bn in April). Thus, the bid-to-cover ratio improved to 1.30x (vs 1.20x in April), attributable to the drop in the amount allotted. Cumulatively, the marginal rates on the FEB 2028, APR 2032 and JAN 2042 bonds increased by 10bps, 20bps and 29bps to 14.10%, 14.90%, and 15.69%, respectively, while that of APR 2049 remained flat at 15.80%.

Given the current tight system liquidity of NGN190.93bn as of June 15, we expect marginal rates on the offered instruments to hover around the range of 14.00% - 15.90% in the upcoming auction. Against the backdrop of negative real returns and weak macro fundamentals, FGN bond investors could potentially demand higher rates as incentives. Also, we posit that the new instruments on offer could attract significant investors' interest, given the potential for capital gains.

In the secondary market, the mood has been slightly bullish since the last primary market auction, as the average bond yield fell to 13.78% as of June 16 from 14.31% at the previous auction date. In the near term, we expect the current bullish sentiment to persist despite negative real rate returns.

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, FGN JUN 2033**, **FGN JUN 2038** and **FGN JUN 2053** offer 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	102.54	13.89%	14.00% - 14.20%
FGN JUN 2033	N/A	N/A	14.80% - 15.00%
FGN JUN 2038	N/A	N/A	15.40% - 15.50%
FGN JUN 2053	N/A	N/A	15.70% - 15.90%

N/A – Not Available

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 analyzed the issues on offer given the current yield environment, market liquidity, and 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

Ahead of Next Bond Auction

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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