MERISTEM

Ahead of Next Bond Auction

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

14.55% APR 2029	12.50%
14.70% JUN 2033	13.60%
15.45% JUN 2038	14.10%
15.70% JUN 2053	14.30%

Amount:

14.55% APR 2029	NGN52.62bn
14.70% JUN 2033	NGN39.86bn
15.45% JUN 2038	NGN146.49bn
15.70% JUN 2053	NGN417.77bn

SUMMARY OF CURRENT AUCTION

FGN APR 2029

Auction Date	14/08/2023
Settlement Date	16/08/2023
Maturity Date	26/04/2029
Next Coupon Date	23/10/2023
Clean Price	105.50

FGN JUN 2033

Auction Date	14/08/2023
Settlement Date	16/08/2023
Maturity Date	21/06/2033
Next Coupon Date	21/12/2023
Clean Price	104.02

FGN JUN 2038

Auction Date	14/08/2023
Settlement Date	16/08/2023
Maturity Date	21/06/2038
Next Coupon Date	21/12/2023
Clean Price	102.98

FGN JUN 2053

Auction Date	14/08/2023
Settlement Date	16/08/2023
Maturity Date	23/06/2053
Next Coupon Date	23/12/2023
Clean Price	102.52

FGN Bond Auction Scheduled for 14th August 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, August 14, 2023. The total amount on offer is expected to be between NGN320bn and NGN400bn from four issues. The instruments include four re-opening issues (APR 2029, JUN 2033, JUN 2038, and JUN 2053)

14.55% FGN APR 2029	**NGN80bn – NGN100bn**
14.70% FGN JUN 2033	**NGN80bn – NGN100bn**
15.45% FGN JUN 2038	**NGN80bn – NGN100bn**
15.70% FGN JUN 2053	**NGN80bn – NGN100bn**

Current Yield Analysis

Due to the robust system liquidity ahead of July's Primary Market Auction (PMA), subscriptions were significantly improved across the offered instruments. Total subscription at the auction rose by 48.82% MoM to NGN945.14bn (vs. NGN635.11bn at the June PMA). Although the total amount allotted increased by 53.75% MoM to NGN656.74bn (vs NGN427.15bn at the previous auction), the bid-to-cover ratio moderated to 1.44x (vs 1.49x in June). This can be traced to the relatively lower amount allotted in proportion to the total subscription. As a result, the marginal rates on the instruments declined by 140bps, 110bps, 135bps, and 140bps to 12.50%, 13.60%, 14.10%, and 14.30%, respectively.

In the forthcoming auction, we expect an increase in the marginal rates of all instruments on offer. First, we recognize the recent monetary authority's measure to manage system liquidity as a key driver for higher rates at the bond auction. Also, the current macroeconomic headwinds and stubbornly high inflation rate could prompt investors to bid for higher rates as incentives.

The secondary market has been slightly bearish since the last primary market auction, with the average bond yield rising to 13.52% as of August 11 (80bps higher than the last auction date). This bearish sentiment is expected to continue in the near term.

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, 14.70% FGN JUN 2033**, **15.45% FGN JUN 2038** and **15.70% 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	105.50	13.14%	13.00% - 13.80%
14.70% FGN JUN 2033	104.02	13.93%	13.80% - 14.00%
15.45% FGN JUN 2038	102.98	14.94%	14.50% - 15.00%
15.70% FGN JUN 2053	102.52	15.30%	15.00% - 15.70%

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

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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