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Analysts:

Renaldo D'Souza

Renaldo.DSouza@sterlingib.com

Davis Gathinji

Davis.Gathinji@sterlingib.com

Isabel Chakairu

Isabel.Chakairu@sterlingib.com

Email: research@sterlingib.com

Bond Dealing: +254 (20) 2213914/0723 153 219

Email: invest@sterlingib.com

Office Address: Delta Corner Annex, 5th Floor, Ring Road Westlands.

Website www.sterlingib.com

Bloomberg Code: SCLK <GO>



Fixed Income Primary Bond Issue

(Switch Auction IFB1/2022/6)

December 2022

“CBK surprises with KES.88Bn Switch Bond”

Switch Infrastructure Bond IFB1/2022/6 auction

- The Central Bank of Kenya (CBK) has issued a switch Infrastructure Bond: **IFB1/2022/6** (Table 1).
- Investors eligible to participate in this auction are holders of T-bills **2494/91**, **2454/182**, **2380/364** and T-bond **FXD1/2021/2** as at 30th November 2022.
- This is the second time that the CBK has issued a switch bond with a similar one issued in June 2020.
- Like the previous one, we believe that the main reason for this issue is to lengthen the maturity profile of domestic debt and thus reduce refinancing risk especially with the KES.87.8Bn falling due in January 2023 (Table.2).
- As was the case then and has been the case in most recent IFBs, we expect subscription upwards of 80% with some investors expected to redeem their investments.
- We note that the value date is 5th December 2022 meaning that the T-Bills and T Bond are being redeemed ahead of their maturity dates (9th January 2023) and investors in these securities will benefit from the accrued interest up to 5th December 2022.
- This essentially means that no coupon will be paid on **FXD1/2021/2**.

Table.1: Switch Bond issue summary

Issue Number	IFB1/2022/6
Total Amount Offered	KES.87.8Bn
Tenor (Years)	6 Years
Effective Tenor (Armotized)	4.5 Years
Coupon Rate (%)	Market Determined
Issue Price	Discounted/Premium/Par
Period of Sale	22nd November to 30th November 2022
Auction Date	1st December 2022
Value Date	5th December 2022
Minimum Amount	KES.100,000
Eligibility at Primary Issuance	Investors with minimum holdings of KES.100,000 in T-Bills and T-Bonds earlier mentioned as at November 30th 2022.
Yield Curve (%) (Weighted Average tenor - 4.5 years) 25th November 2022	13.4020

Source: Central Bank of Kenya & Sterling Capital Research

Table.2: Maturing domestic debt issues

Debt Issue	Redemption Amount (KES.Bn)	Maturity Date
2494/91	10.97	Jan-2023
2454/182	8.8	Jan-2023
2380/364	12.19	Jan-2023
FXD1/2021/2	55.8	Jan-2023
Total	87.81	

Source: Central Bank of Kenya & Sterling Capital Research

Our market weighted average bid predictions

- Our market-weighted average bid prediction is guided by implied yields of securities of similar tenors on the Nairobi Securities Exchange (NSE) as at 25th November 2022 and discussions with several fixed income traders (Table.3).

Table.3: Auction bid predictions

Rate	IFB1/2022/6
Market Weighted Average bid prediction (%)	13.35 - 13.50

Source: Sterling Capital Research

Historical debt issues guide our predicted rates

- We used implied yields of bonds of almost similar tenors to maturity on the NSE as at 25th November 2022 as a guide for possible investor auction bid levels (Table.4).
- The previous switch bond **IFB1/2020/6** had a similar yield - 11.6045% to 5 year debt issue (as at 31st May 2020).
- Weighted average accepted rate of investor bids was at 11.602%.
- Using a similar framework to what's highlighted above, we have selected **FXD1/2017/10** and **FXD1/2012/15** as guides also taking into account recent interest rate movements including the third upward revision of the Central Bank Rate (CBR) this year to 8.75% on 23rd November 2022.

Table.4: Benchmark issues to guide investor bids

Treasury Bond	Issue Date	Coupon Rate (%)	Maturity Date	Term to Maturity Years (Days)	Implied Yield to maturity (%)	Yield Curve at time of issue
FXD1/2017/10	31st Jul 2017	12.9660	19 th Jul 2027	(4.6) 1,697	13.3161	12.9660
FXD1/2012/15	24th Sep 2012	11.0000	6 th Sep 2027	(4.8) 1,746	13.3875	11.6000

Source: Central Bank of Kenya

Our view

- This switch bond comes as a surprise to the investor market as was the case with the debut switch bond.
- It also comes soon after the primary issue and tap sale of **IFB1/2022/14** both of which were oversubscribed signaling high fiscal financing needs.
- Recent IFB auctions have exhibited huge investor appetite for the reasons mentioned above.
- We also used results of the first ever switch bond auction to determine the likely subscription outcome of this issue (Table 5).
- As it is not a mandatory switch bond, we would expect some investors to reject it perhaps due to their liquidity needs or preference for shorter duration investment instruments especially in an environment of rising interest rates.

- For investors eligible to invest in this issue, it makes good investment sense in consideration of the relatively short investment duration, the attractive return (also taking its tax free status into consideration).
- We also expect high demand in the secondary market due to its attractive coupon and attractive tenor meaning a huge opportunity for making capital gains.

Table.5: Historical IFB primary market switch auction performance

Issue	Issue Date	Offered (KES.Bn)	Bids Received (KES.Bn)	Amount Accepted (KES.Bn)	Performance Rate (%)	Coupon Rate (%)	Implied Yield (%)
IFB1/2020/6	Jun-2020	25.6	21.2	19.3	82.8%	10.2	12.3000

Source: Central Bank of Kenya

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