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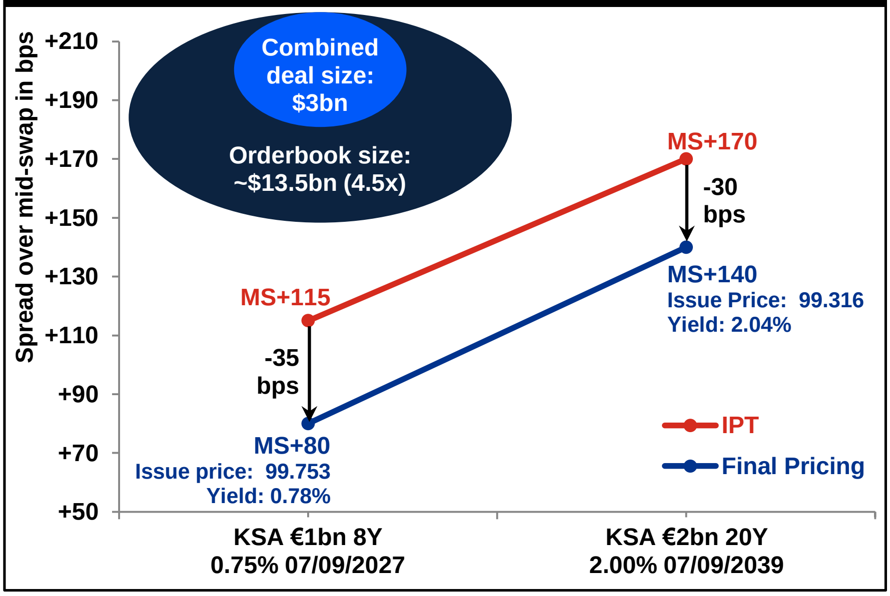
Saudi Arabia charters new territory with its €3bn deal

The Kingdom of Saudi Arabia (KSA) debuted in the European bond market on 2nd July by selling a dual tranche EURO denominated deal worth €3bn ($3.4bn), and thus become the first GCC sovereign to issue EURO denominated bonds. KSA priced a €1bn 8-year 2027 bond at MS+80bps, 35 basis points inside the initial guidance, offering yield of circa 0.78%. The second tranche of the deal, a €2bn 20-year 2039 bond, was priced at a spread of 140 basis points over benchmark mid-swap rate, 30 basis points inside the initial guidance, and offered yield of circa 2.04%. The deal attracted combined orderbook of circa €13.5bn, making the deal more than four times oversubscribed.

Deal statistics



Source: Bloomberg/Saudi Ministry of Finance/FAB

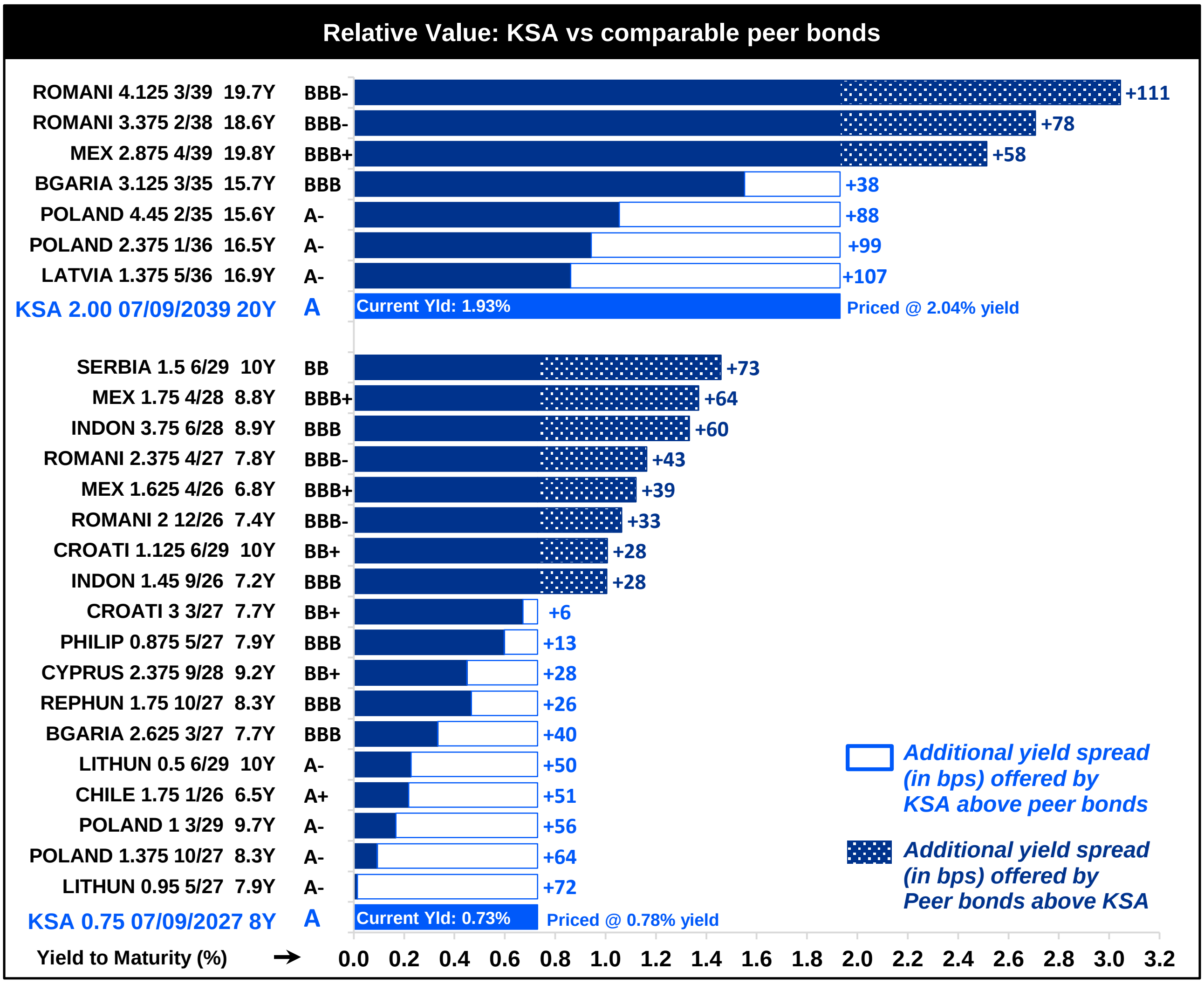
With the euro deal, Saudi Arabia successfully locked in record low coupon, thanks to the negative yielding European bond market, and opened up another source of funding for the future. For example, for the 8-year EURO bond, KSA is paying a coupon of 0.75%, while for a similar maturity US$ Islamic bond, KSA is paying coupon of 3.628% (current yield at 3.02%). KSA's 20-year EURO bond carries coupon on 2.00%. When compared to the 4.25% coupon that Saudi Aramco is paying on its 2039 bond (current yield at 4.06%), the 2.00% coupon for KSA 2039 looks like a great deal for the issuer. The chosen tenors also help Saudi Arabia to extend its debt maturity profile, avoiding any front loading of the curve.

If we swap the Euro currency bonds of Saudi Arabia to USD, the final pricing is in line with Saudi Arabia's existing US$ curve on asset swap basis. For example, the ASW spread for Saudi Arabia's 3.628% 04/20/27 sukuk is 119 basis points while the US$ equivalent ASW spread for the 2027 EURO bond is 118bps. That mean Saudi Arabia managed to lock in record low coupon, while pricing the EURO bonds in line with its US$ curve, and still offered some compelling risk-reward benefit to its new set of investors to keep the deal attractive in the secondary market.

Relative Value

Due to the near-zero to negative yielding debt market in Europe, investors from the region are hunting for yield and looking more and more in to the emerging market issuers. As a result, 2019 has so far witnessed a record €31bn of EURO currency issuance from emerging markets. For example, the second quarter of 2019 so far has seen EURO currency issuances from countries like Turkey, Philippines Indonesia, Ukraine, Serbia, Latvia, Croatia etc.

Saudi Arabia joined the party slightly late, which was more about timing in our opinion to lock in better funding cost. Saudi Arabia's EURO denominated bonds, with credit ratings better than most EM sovereigns, still offer some good pick up in the secondary market on a relative value basis, as we believe that the issuer opted to leave some premium for its investors. That is indeed a prudent strategy by the sovereign's Debt Management Office (DMO) in our opinion as the Kingdom needs to tap global bond market on a regular basis going forward. The below chart shows how Saudi Arabia's latest EURO bonds stack against some of the peer bonds from the emerging market space.



*Source: Bloomberg/FAB; * Ratings shown are composite credit rating, that is average rating of the ratings assigned by Moody's, S&P & Fitch*

The euro denominated deal adds another feather to the sovereign's Debt Management Office which is spearheading Saudi Arabia's foray in to the international debt capital market since the kingdom debuted in 2016 with a $17.5bn 3-tranche US$ deal. Ever since, Saudi Arabia has become one of the most prolific sovereign issuers in the Emerging Markets space by printing record jumbo deals each year, which is primarily to fund its budget shortfalls. With just over three years of history in the Eurobond market, Saudi Arabia's DMO has indeed proven that it remains engaged with its trusted international investor community and keeps diversifying its funding base by executing deals swiftly and opportunistically. The latest Euro deal is only a testament to this.

KSA held a non-deal investor road show in Europe during mid of June, amid heightened geopolitical tensions in the region. The deal shows that the sovereign received some very good response from European investors, waited for the right time, and swiftly executed the deal on 2nd July after holding an investor call the previous day. The inclusion of GCC countries, including Saudi Arabia, in JP Morgan's Emerging Markets Bond Index this year completed the official missing link between emerging markets fixed income and GCC fixed income, which was in general treated as EM credit by international investors before the inclusion but lacked the index tracking passive trading inflow.

Net net, very positive developments for the GCC fixed income markets, widening its appeal to a range of investors across the globe!

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