

## Credit Analysis

## African Development Bank

### Ratings

#### African Development Bank

#### Foreign Currency

Long-Term	AAA
Short-Term	F1+
Outlook	Stable

Individual	-
Support	-

### Financial Data

#### African Development Bank

	31 Dec 2003	31 Dec 2002
Total Assets (USDm)	14,848.9	11,063.5
Total Assets (XDRm)	9,992.7	8,139.4
Equity (XDRm)	3,509.6	3,390.2
Net Income before IAS 39 (XDRm)	178.3	188.8
Net RoA (%)	1.29	2.66
Net RoE (%)	3.40	6.91
Equity/Assets (%)	35.12	41.65
Available Equ./Required Cap. (%)	776.02	685.7

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### Rating Rationale

#### Assessment

- African Development Bank's ("AfDB") ratings are primarily based on the support from its member countries, which include several highly-rated, non-African shareholders, sound credit policies and its preferred creditor status, common to all Multilateral Development Banks ("MDBs"), which gives AfDB priority over other lenders.
- AfDB's mandate is to distribute financial aid to African developing countries. The poorest have access to concessional funds – i.e. loans with extremely low interest rates and long repayment periods - distributed by the African Development Fund ("ADF"). These loans are funded by grants from donors and are not recorded on AfDB's accounts. Currently, only 15 countries are eligible to borrow from AfDB, including two that can also borrow from the ADF. The Bank has significant credit risk exposure compared to other MDBs given the high risk profile of the majority of its African sovereign borrowers, and, more specifically, following the default of Zimbabwe and Côte d'Ivoire in 2000 and 2003, which increased non-accrual loans to 21.2% of outstandings at end-2003 (versus 14.3% in 2002). An initiative supported by the donor community has helped clear the arrears of the Democratic Republic of the Congo ("DRC") and substantially reduced the bank's total arrears in the last two years. AfDB has continued to improve its loan loss coverage, with provisions amounting to 8.4% of loans at end-2003, and covering 40% of impaired lending.
- The bank's loan portfolio has been contracting since the late 1990s because of the country eligibility policy implemented since 1995 that restricts lending to the 15 most creditworthy countries. In 2003 the amount of approvals declined while the low interest rate environment prompted a number of borrowers to prepay their old fixed-rate loans. To reverse this trend, the bank has introduced new products and instruments including non-sovereign guaranteed loans and has increasingly emphasised private sector lending, which, however, accounted for only 4.1% of its total portfolio at end-2003.
- The bank's liquidity is excellent; it holds a large portfolio of highly rated treasury assets managed against various benchmarks including LIBOR. In addition, it adheres to a prudent asset and liability management strategy ("ALM") with a neutral interest rate and currency risk exposure.
- Capitalisation is sound at AfDB, ranking among the highest of the MDBs, as demonstrated by the ratio of available equity to required capital of 776.02% at end-2003.

#### Support

- AfDB's capital is held by 77 member countries, 53 of which are African. Fitch Ratings views the uncalled subscribed capital of the highly-rated countries, notably those rated 'AA' and above, as a principal factor supporting the bank's ratings. The in-depth reforms that AfDB has implemented since 1995 have restored shareholder confidence, as illustrated by the 35% capital increase in 1999. One of the consequences of the recent capital increase is the strengthening of non-African members' shareholding to 40% from 33%.

### Background

- AfDB is an MDB created to assist the economic and social development of its regional member countries. The bank, which is headquartered in Abidjan (Côte d'Ivoire), employed 987 staff at the end of 2003. Following the outbreak of civil unrest in Côte d'Ivoire, the bank's staff and activities have been temporarily relocated to Tunis (Tunisia) since early 2003.
- AfDB advances loans directly to governments to finance development projects and programmes in a variety of sectors. It is also involved, to a lesser but increasing extent, in supporting private sector activities through loans, guarantees and equity participations. The ADF and the Nigerian Trust Fund ("NTF") are managed by AfDB but are financially independent.

## ■ PROFILE

- **Finances development projects in African countries**
- **Public lending restricted to 15 countries**

### Historical Background

AfDB, an MDB established in 1964 and headquartered in Abidjan (Côte d'Ivoire), is mandated with promoting economic and social development within its regional member countries. In the early 1990s, the bank faced an internal crisis that resulted in the replacement of 70% of the management team and the appointment of Mr. Omar Kabbaj, from Morocco, as President. The new team comprehensively reformed credit and financial policies to improve the bank's risk profile. These reforms restored shareholders' confidence, which led to a capital increase in 1999, the fifth in the bank's history, as well as regular replenishment of the ADF, with the ninth such replenishment in September 2002. In addition, negotiations for the 10th replenishment of the ADF have been initiated. In 2003, the growing political instability in Côte d'Ivoire forced AfDB's Board of Governors to temporarily relocate operations to back-up facilities in Tunis (Tunisia) in 2003. This is reviewable at the annual general meetings of the AfDB Group. On the basis of the most recent assessment, the bank staff are not expected to return to Abidjan before 2006.

### Organisation

The bank employed 987 staff at the end of 2003. Each member country of AfDB appoints a governor to the Board of Governors, the ultimate decision-making body. Among other things, the Board approves capital increases, the admission of new members and defines the bank's strategy. AfDB has an 18-member resident Board of Directors representing the 77 member countries, which oversees operations and policy-making. Six directors represent non-African countries while 12 represent African nations. While decisions are taken on the basis of a two-thirds majority, members have the right to request a 70% weighted majority. The bank's president is responsible for day-to-day management and is elected by the Board of Governors for a term of five years (and a maximum of two terms).

### Activities

The AfDB Group (AfDB, ADF and NTF) provides development financing and technical assistance to its regional member countries. Funds are channelled through three routes based on a country eligibility policy: AfDB, which is limited to offering financial assistance to 15 countries, the ADF, which grants concessional financial assistance to countries that currently cannot borrow from AfDB, and the NTF, a

fund set up by Nigeria to support the development efforts of the African countries, particularly the low income nations. The ADF and NTF have access to concessional resources subscribed by donor countries and loans advanced under extremely favourable conditions. While managed by AfDB, both the ADF and NTF are financially autonomous.

In the period 2001-2003, loans approved by the bank averaged between UA1,500m<sup>1</sup> and UA1,700m. The bank accounted for less than half of the loans/grants advanced by the Group (42.3% in 2003) given its commitments are restricted to only 15 countries (see *Credit Risk*). ADF financing makes up the bulk of the balance, with the NTF representing a marginal share. AfDB's role is not only to participate with its own resources but also to raise financing from other sources. To that end, it seeks co-financing agreements, generally with local financial institutions and other MDBs, particularly the World Bank. In 2003, 28 projects totalling UA3.91 billion were co-financed; the Group's contribution amounted to 18.8% of those projects. AfDB's commitments take various forms, as illustrated in the table below.

### AfDB Approvals by Instrument (1999 – 2003)

(UAm)	2003	2002	2001	2000	1999
Project Loans	565.6	689.9	568.4	402.2	570.1
Public	359.8	491.0	376.4	375.0	472.7
Private	205.8	198.9	192.0	27.2	97.4
Equity investments	-	-	-	2.3	4.7
Policy-Based Loans	176.6	185.6	232.1	-	198.0
Emergency Aid	3.6	4.6	1.2	-	-
Total Direct Financing	745.8	880.1	801.7	404.6	772.8
HIPC* Debt Relief	-	188.0	174.9	173.9	20.8
Guarantees & Other	-	-	10.1	264.7	0.7
<b>Total</b>	<b>745.8</b>	<b>1,068.1</b>	<b>986.7</b>	<b>843.2</b>	<b>794.3</b>

\* Heavily Indebted Poor Countries  
Source: AfDB annual report

Fitch distinguishes direct financing (loans and equity) from other forms of development assistance that do are not reported on-balance sheet, such as debt relief – financed by the HIPC (Heavily Indebted Poor Countries) Trust Fund. The bank also provides guarantees, which are recorded off-balance sheet.

Project loans, AfDB's principal product, representing 75.8% of direct financing in 2003, are

<sup>1</sup> UA – Unit of Account; 1 UA = 1 SDR (Special Drawing Right or XDR; equivalent to USD 1.37 in 1999 and USD1.48 in 2003)

channelled into agriculture, utilities, transport, industry, health and education. Two thirds of project loans take the form of financing government-guaranteed projects, advances to other public sector entities and credit lines to public financial institutions, which in turn allocate the funds to various projects. Disbursements are spread over a project's life. The bank can cancel undisbursed loan balances for non-performing projects. Under its sanctions policy, the bank suspends disbursements if a country is more than one month in arrears.

Financing provided to the private sector is now a strategic priority for AfDB, having increased significantly in the last two years to represent 27.6% of direct financing approvals in 2003 versus 22.6% in 2002, albeit accounting for only 4.1% of total outstanding loans at end-2003. The Board of Governors has authorised the bank to distribute loans to public corporations without formal sovereign guarantees; this will result in the coming years in a reduction of the share of sovereign-guaranteed loans. Private sector financing takes the form of project finance, credit lines granted to local banks or equity participations; the latter type of intervention has not been used in the last three years. The bank restricts its commitments to private projects to one-third of total financing.

Policy-based loans comprise credit facilities extended to finance clearly-identified reform programmes in regional member countries. They may also be offered in the context of aid packages to African countries in difficulty. These loans are usually co-financed by other multilateral development institutions – the World Bank, the EU, the EIB – and disbursement is generally conditional upon implementation of adjustment policies recommended by the IMF.

No further debt relief under the HIPC Initiative was approved in 2003, though qualifying countries continued to make progress in implementing sound economic policies. The HIPC Initiative was launched in 1996 by governments of developed countries and multilateral creditors to alleviate the debt burden of the poorest countries. Debt relief is conditional upon the implementation of sound macro economic and financial policies. An enhanced framework was approved in 1999 to provide faster and broader debt relief. 32 African countries are eligible for assistance but so far only 23 have fulfilled the conditions to qualify for debt relief (known as the *decision point*). Once approval has been given, countries must demonstrate their ability to pursue sound economic policies for generally between two to four years before the debt relief process becomes irrevocable and aid is fully disbursed (the *completion point*). At

end-July 2004, 11 countries had reached the *completion point* - Benin, Burkina Faso, Ethiopia, Ghana, Mali, Mauritania, Mozambique, Niger, Sénégal, Tanzania and Uganda – and 12 countries were at the *decision point*. At end-July 2004, nine African countries potentially eligible for HIPC relief had still not reached the decision point due to unstable political environments, with most of these countries facing civil war or post-conflict situations.

African countries will receive debt relief amounting to an estimated USD24.8bn in net present value ("NPV") terms through multilateral and bilateral donors. The AfDB Group's share will total USD3.9bn (including debt relief granted to the DRC under the arrears clearance mechanism approved in 2002); debt relief approved for the 23 countries amount to USD2.5bn in NPV terms, out of which USD557.9m had actually been granted at end-June 2004. The real cost for the Group will be USD370m, as bilateral donors will contribute the majority of the package; USD124m (less than 5% of equity) will come from the bank's net income generated over the life of the HIPC Initiative, and the remainder will be funded through the ADF and loan cancellations.

## ■ CAPITAL, FUNDING AND LIQUIDITY

- **Strong shareholder support including ownership by highly-rated non-African countries**
- **Strong capitalisation and liquidity**

### Capital

A total of 60% of the bank's capital is owned by the 53 African member states, and 40% by 24 non-regional member countries. Nigeria, Egypt and South Africa are AfDB's largest African shareholders. In 1999, authorised capital increased by 35% to UA21.9bn, with the non-regional members' stake rising from one-third to the current 40%. The latter therefore hold a blocking minority

### AfDB's 10 Largest Shareholders at End-2003 (%)

<b>Total Non-African Countries</b>	<b>39.91</b>
USA	6.64
Japan	5.47
Germany	4.12
France	3.75
Canada	3.75
<b>Total African Countries</b>	<b>60.09</b>
Nigeria	9.12
Egypt	5.16
South Africa	4.04
Algeria	3.83
Côte d'Ivoire	3.76
<b>Total</b>	<b>100.00</b>

Source: AfDB annual report

on the Board of Governors' General Assembly, where a majority of two-thirds is required. At end-2003, subscribed capital totalled UA21.6bn. Like other MDBs, paid-in capital only corresponds to a fraction (10.8% at end-2003) of subscribed capital. At end-2003, subscribed capital consisted of UA2.2bn in paid-in capital and UA19.4bn of subscribed but uncalled capital, or callable capital. Of this, arrears on capital payments from certain shareholders (UA12.7m in 2003 versus UA9.5m in 2002) should be deducted as instalments due on but not current are forfeited after a set period of time. The paid-in portion of the 1999 capital increase was payable in eight equal annual instalments.

Like other MDBs, AfDB is not subject to international banking regulations and, as a consequence, does not have to publish standard capital ratios. Nonetheless, the bank employs prudent and conservative internal measures of capital adequacy, where unexpected losses on assets are compared to risk capital, comprising shareholders' capital, reserves and general provisions.

## Capital Adequacy Measures (Fitch Definition)

	2003	2002	2001
Authorised Capital (UAm)	21,870	21,870	21,870
Subscribed Capital (UAm)	21,564	21,510	21,491
Callable Capital (UAm)	19,383	19,376	19,395
Paid-in Capital (UAm)	2,181	2,135	2,096
Shareholders' Equity (UAm)	3,510	3,390	3,152
Usable Equity (UAm)	10,807	10,599	10,361
Available Equity (UAm)	18,718	18,619	18,387
Required Capital (UAm)	2,417	2,715	2,999
Usable Capital/Required Capital (x)	4.47	3.90	3.46
Available Equity/Required Capital (x)	7.744	6.857	6.131

Source: AfDB annual report; Fitch

Fitch views callable capital as a shareholder guarantee that can be exercised by the bank to meet obligations associated with an AfDB borrowing or guarantee. To compare the solvency of all MDBs, the agency has developed its own capital adequacy measures (see "*Risk Analysis of Multilateral Development Banks*" dated March 1999 and available on [www.fitchratings.com](http://www.fitchratings.com)), based on the analysis of the credit quality of both borrowers and shareholders. It calculates required capital to cover a bank's credit risk against available equity (paid-in capital, reserves and a portion of callable capital). AfDB's ratio of available equity to required capital, among the highest of the MDBs, has been steadily improving since the 1999 capital increase, reflecting the portfolio consolidation since the late-1990s and the strengthening of the bank's equity.

## Funding

Like other MDBs, AfDB does not accept deposits; its 'AAA' rating gives it access to lower cost sources of capital market funding. In 2003, the bank raised a total of UA2,189m in the capital markets with an average 7.2 year maturity. Most funding was long-term and carried an average maturity of 7.7 years at end-2003. In addition to a EUR1bn commercial paper programme the bank has an unlimited global debt issuance facility that enables it to issue debt in various forms, currencies and markets. The ceiling on borrowing is set by the Board of Governors at 100% of usable capital, defined as equity plus callable capital subscribed by countries rated 'AA' and above. Limits have also been set for total debt to callable capital and senior debt to callable capital from non-borrowing countries. The bank has also set working guidelines for subordinated debt at 40% of total debt, although this does not constitute a Board-approved limit. AfDB is one of the only MDBs that has issued subordinated debt, but amounted to 12.5% of total borrowings at end-2003. The bank's funding strategy is opportunity-driven. Swaps are extensively used to achieve the matching of assets and liabilities while reducing borrowing costs.

## AfDB's Internal Prudential Ratios

Ratio (%)	Max.	2003	2002	2001
Total Debt/Usable Capital*	100.0	60.6	47.9	50.9
Total Debt/Callable Capital	80.0	29.8	23.0	26.9
Senior Debt/Callable Capital from Non-Borrowing Countries	80.0	59.2	41.7	44.2

\* Usable capital = Callable capital from 'AA/AAA' rated countries + Paid-in capital + Reserves

Source: AfDB's annual report

## Liquidity

AfDB is a highly-liquid bank; liquid assets had increased significantly from UA2.2bn in 2002 to UA4.5bn in 2003, consisting predominantly of tradable securities (55.4%) and securities held to maturity (44.5%), in addition to interbank bank deposits. Liquid assets are invested in hard currencies, primarily US dollars, euros and GBP. Liquidity reserves represent readily-available resources to meet daily cash requirements, but also fund loan and guarantee commitments when access to financial markets is restricted.

The bank's liquidity policy requires that liquid assets be at least equal to the loan equivalent value of guarantees and undisbursed equity investments and private sector loans, plus the following four quarters' net loan disbursements and debt servicing requirements. The prudential minimum level calculation is updated on a quarterly basis. The operating guideline for liquidity is set at a maximum

of the prudential minimum plus 50% of the outstanding undisbursed loans. In addition, the bank cannot invest in placements rated below 'AA-'; the limit is 'A' for money market instruments. Asset-backed securities are restricted to 'AAA'-rated bonds.

## ■ RISK

- **Significant exposure to credit risk and loan concentration**
- **Credit risk sufficiently covered by equity and provisions**

### Credit Risk

#### AfDB's 10 Largest Sovereign Exposures (2002-2003)

	2003		2002	
	UAm	%	UAm	%
Tunisia**	1,157.2	20.6	1,107.3	18.6
Morocco**	595.7	10.6	911.7	15.3
Algeria**	763.9	13.6	753.0	12.6
Nigeria*	491.8	8.8	568.8	9.5
Côte d'Ivoire	359.7	6.4	352.3	5.9
Congo (DRC)	346.7	6.2	347.9	5.8
Egypt**	240.6	4.3	242.7	4.1
Gabon**	183.3	3.3	219.9	3.7
Zimbabwe*	197.2	3.5	204.0	3.4
Republic of Congo	127.5	2.3	138.0	2.3
<b>Sub-Total</b>	<b>4,463.6</b>	<b>82.9</b>	<b>4,845.6</b>	<b>81.2</b>
Other Public Loans	920.3	17.1	1,122.1	18.8
<b>Total</b>	<b>5,383.9</b>	<b>100.0</b>	<b>5,967.7</b>	<b>100.0</b>

\* Countries eligible for both AfDB and ADF loans

\*\* Countries eligible for AfDB loans

Source: AfDB annual report

AfDB extends loans predominantly to sovereigns; while the ratio of private lending has risen steadily in the last few years, it continued to represent just 4.1% of the total at end-2003. These private sector loans carry greater risk than sovereign operations as AfDB does not benefit from preferred creditor status on these facilities (see below). Equity participations, on the other hand, have remained stable for the last three years; as a percentage of total commitments, they are not significant (accounting for 1.2% of total commitments (loans + equity participations) at end-2003.

AfDB's loan portfolio is typical of MDBs operating in developing countries, i.e.:

- The 10 largest exposures accounted for 82.9% of total sovereign loans and 79.5% of AfDB's entire loan portfolio. North African countries alone (Algeria, Egypt, Morocco and Tunisia) represented 49.1% of total loans and 120% of the bank's equity.

- Significant credit risk exposure, reflecting the generally low credit quality of African countries. Thirty-two countries out of 53 are eligible for debt relief under the HIPC Initiative, which suggests that their debt burdens were considered unsustainable. At end-2003, only one (Tunisia) of the 10 largest borrowers was rated investment grade.
- Relatively high loan concentration: The 10 largest exposures accounted for 82.9% of total sovereign loans and 79.5% of AfDB's entire loan portfolio. North African countries alone (Algeria, Egypt, Morocco and Tunisia) represented 49.1% of the total.

The current profile of the loan portfolio reflects the change in credit policy introduced in 1995. AfDB loans are restricted to 15 'eligible' countries<sup>2</sup>; other nations only have access to concessional financing from the ADF bar two (Nigeria and Zimbabwe) that qualify for loans from both AfDB and ADF. The credit policy was intended to rebalance the bank's portfolio towards the countries deemed the lowest credit risk. Two out of the 15 eligible for AfDB loans (the Seychelles and Zimbabwe) are currently in default, while Gabon, which had previously defaulted, is now current on its debt servicing obligations to the bank.

In addition to the HIPC Initiative and the country eligibility policy, the bank has implemented several measures to contain arrears on payments due from clients. As a result, arrears primarily relate to loans granted prior to 1995 to countries in conflict situations and in chronic arrears, such as the DRC,

#### Arrears on Sovereign Loans (2000 - 2003)

(UAm)	2003	2002	2001	2000
Angola	-	-	-	26.7
Burundi	9.4	6.8	7.3	4.8
Central African Republic	3.8	2.4	3.2	3.0
Comoros	12.0	6.4	10.5	9.9
Republic of Congo	99.3	138.0	77.2	61.7
Côte d'Ivoire	77.3	-	44.5	28.5
Congo (DRC)	-	347.9	600.8	569.4
Gabon	-	-	-	29.9
Liberia	117.9	41.6	114.6	110.0
Seychelles	16.3	20.0	7.8	3.5
Somalia	9.1	3.7	7.8	7.6
Sudan	59.0	59.6	45.4	38.2
Zimbabwe	142.2	204.0	80.5	32.8
Others	0.5	-	5.5	7.5
<b>Total</b>	<b>546.8</b>	<b>830.4</b>	<b>1,005.0</b>	<b>933.5</b>

Source: Source: AfDB's annual report

<sup>2</sup> Algeria, Botswana, Egypt, Equatorial Guinea, Gabon, Libya, Mauritius, Morocco, Namibia, Nigeria, Seychelles, South Africa, Swaziland, Tunisia and Zimbabwe.

Republic of Congo, Liberia and Sudan, and peaked at UA1,005.0m in 2001. The main driver of arrears since 2000 was the default of two large borrowers, Zimbabwe and Côte d'Ivoire. As principal and interest payments became due, these arrears continued to build-up, peaking at 24.6% of total loans in 2000; also a peak across all the MDBs. This trend was reversed in 2002 with the combined effect of the HIPC Initiative and a specific arrears clearance mechanism sponsored by the donor community and implemented for the DRC, the largest borrower in arrears, offsetting for the most part the 2002 default of Côte d'Ivoire. In 2002, the bank participated in a coordinated operation with the IMF, the World Bank and the international community to clear the arrears of the DRC, consolidating the amounts due in a restructured 20-year loan. In 2003, the DRC qualified for debt relief under the HIPC Initiative. The bank complements donor resources raised for debt relief for the DRC through annual allocations to a special account that will provide relief on the DRC's interest payments on its consolidated loan.

While the HIPC Initiative helped the bank reduce non-accrual loans in 2001, any benefit has been diluted by the default of Côte d'Ivoire and Zimbabwe. No improvement is expected in the short- and even medium term, given the political situations in both countries. The difficulty in clearing the DRC arrears highlights the limits of the HIPC Initiative for the poorest and/or politically unstable countries, in particular the Republic of Congo and Liberia, which account for the largest remaining arrears of the bank, followed by Sudan, the Seychelles, Burundi, the Comoros and the Central African Republic. For countries emerging from conflict, the bank has established a post-conflict facility, which, with the financial assistance of the international donor community and maximum effort from the countries themselves, will be used to clear their. Significant progress has already been made in the cases of Burundi and The Republic of Congo. The post-conflict country facility like the Special Account for the DRC will be held off-balance sheet

## Non-Accrual Loans and Provisions (1999 to 2003)

(UAm)	2003	2002	2001	2000	1999
Non-Accrual Loans	1,188.2	851	1,286	1,620	981
Balance Sheet	469	492	494	422	387
Provisions					
Non-Accrual Loans/Loans (%)	21.2	14.3	19.9	24.6	14.4
LL Reserves/Loans (%)	8.4	8.2	7.6	6.4	5.7
LL Reserves/Non-Accrual Loans (%)	40	58	38	26	39

Source AfDB's annual report

and funded by grants from donors and contributions from the AfDB Group.

In accordance with its policy, AfDB makes general provisions for statistically-likely losses and specific provisions where a permanent impairment can be reasonably assessed. Coverage of non-accrual loans has improved since 2002; general and specific provisions have been built up since 1995, bringing loan loss reserve coverage to 8.4% of gross loans at end-2003. Specific provisions for private sector loans amounted to 8.6% of outstandings at the end of 2003. However, following the default of Côte d'Ivoire, provisions now only cover 40% of non-accruals versus 58% in 2002. This significant credit risk exposure is, however, mitigated by AfDB's preferred creditor status on public sector loans, which gives it priority over other creditors in the event of a sovereign default. In addition, like other MDBs, the bank applies stringent rules when principal or interest is more than 30 days overdue by halting disbursement of AfDB, ADF, and NTF loans as well as approval of any new loans. Loans in arrears for more than six months are classified as non-accrual.

### Market Risk

Since 1996, the bank has implemented a policy of reducing exposure to non-core business risks such as market risk. To achieve this, the bank employs a strategy of currency and interest rate matching across the balance sheet. In the area of interest rate risk the bank manages its floating-rate assets and liabilities within a framework of a six-month LIBOR benchmark and risk limits. For its fixed-rate assets, which are funded by the bank's shareholder resources, the bank passively matches the repricing profile to a five-year duration benchmark.

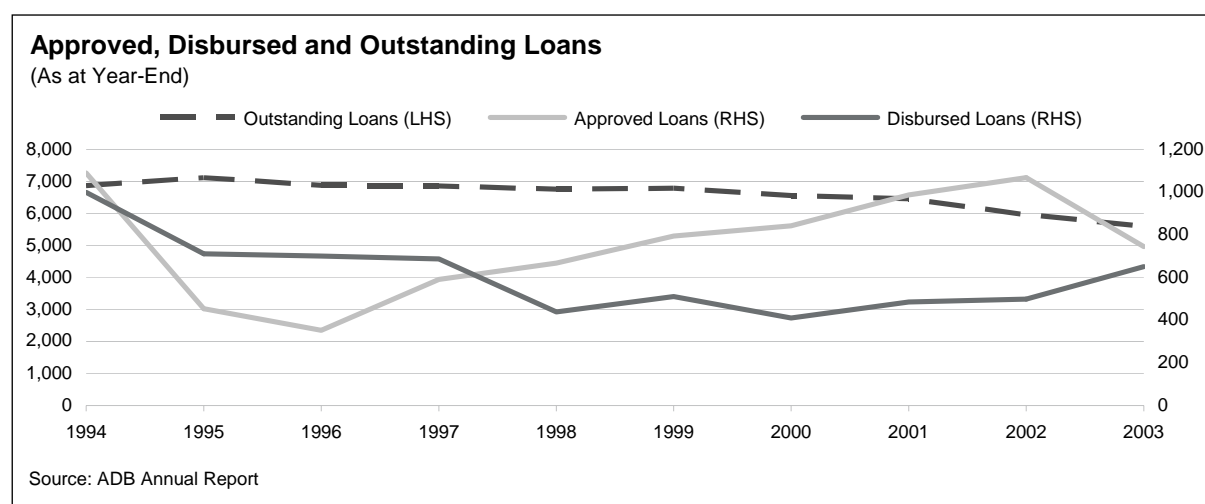
### Operational Risk

AfDB has a business continuity services contract with a Parisi provider to ensure data security and that critical services, including debt servicing and payments to creditors, are current. These facilities proved their effectiveness during the political turmoil in 2000 in Côte d'Ivoire, when the bank's main office in Abidjan was closed for one week.

## ■ PERFORMANCE AND PROSPECTS

- Revenues impacted by high level of prepayments in 2002 and 2003.
- Limited growth potential due to insufficient viable projects to finance in Africa

AfDB presents its accounts in accordance with International Financial Reporting Accounting Standards ("IFRS"). In 2001, the bank adopted International Accounting Standard number 39 (IAS#39), "Financial Instrument Recognition and



Measurement”, which requires that all derivative instruments be booked at fair value. Like other MDBs, profitability is not one of AfDB’s primary objectives. However, improving profitability is a means of increasing its equity base, building up reserves and, thus, further enhancing its development capacity and credibility.

#### Performance

Net income decreased by 48.1% in 2003, primarily due to unrealised derivative valuation changes under IAS#39. However, operating income, that is income before the IAS#39 adjustments, fell by 5.57%, due in a large part to higher expenses related to the temporary relocation to Tunis.

Despite a 34.9% increase in revenues from a twofold increase in liquid assets, net interest revenue fell in 2003 (-4.4% compared to 2002), attributable to:

- significant prepayments on loans in 2003 (UA473m, a record high for the bank); some of these loans were old fixed-rate facilities bearing high interest rates; and
- the return of Côte d’Ivoire to non-accrual status with arrears on interest increasing from UA33.4m in 2002 to UA80.9m in 2003.

In addition, clearance of the DRC arrears implies that a portion of the bank’s net income will, subject to approval annually by the Board of Governors, be allocated to fund the Special Account for the DRC.

AfDB’s personnel and administrative costs recorded a marked increase for the second year in a row (+30.1% in 2003 and 10.0% in 2002); this is in great part attributable to the relocation to Tunis. While the majority of the relocation-related costs were of a one-off nature, some will be recurring during the

temporary relocation. The effect of the increase in expenses in 2003 was, however, substantially muted by the reversal of loan loss provisions following the contraction (-6.0%) in the public loan portfolio in 2003.

The IAS#39 adjustment had a negative impact on earnings in 2003 (-UA60.9m). This however, does not affect the bank’s solvency as, over the life of any derivative instruments, positive adjustments will offset any negative influences.

#### Prospects

Loan approvals fell markedly in 2003, reversing the trend since the late 1990s and reflecting a shortage of viable public projects to finance and competition from other development institutions. This will impact disbursements after a period of two to three years given the pattern of loan disbursements. In addition, record prepayments in 2002 and 2003 have resulted in a contraction in the loan portfolio (-6.0% in 2003).

In the short- to medium term, loan growth will continue to be constrained by the bank’s credit policy, which limits public lending to only 15 countries, two of which are currently in default, and potential prepayments in the continued low interest rate environment. A further contraction in the loan portfolio can reasonably be expected in 2004, followed by a squeeze in the net interest margin as “old” fixed-rate loans attracting high interest rates continue to amortise. To compensate for this, the bank has introduced new products and instruments, including non-sovereign guaranteed loans, and has increasingly emphasised private sector lending, enclave projects and commercially-oriented publicly-owned entities.

## Income Statement Analysis AFRICAN DEVELOPMENT BANK

	31 Dec 2003		31 Dec 2002		31 Dec 2001		31 Dec 2000	
	Income	As % of	Income	As % of	Income	As % of	Income	As % of
	Expenses	Total AV	Expenses	Total AV	Expenses	Total AV	Expenses	Total AV
	XDRm	Earning Assts	XDRm	Earning Assts	XDRm	Earning Assts	XDRm	Earning Assts
	Original	Original	Original	Original	Original	Original	Original	Original
1. Interest Received	414.9	4.86	463.0	5.84	555.0	6.78	511.3	6.46
2. Interest Paid	215.3	2.52	254.3	3.21	345.2	4.22	334.7	4.23
<b>3. NET INTEREST REVENUE</b>	<b>199.6</b>	<b>2.34</b>	<b>208.7</b>	<b>2.63</b>	<b>209.8</b>	<b>2.56</b>	<b>176.6</b>	<b>2.23</b>
4. Other Operating Income	7.1	0.08	20.2	0.25	9.8	0.12	11.4	0.14
5. Other Income	105.5	1.24	82.8	1.04	74.5	0.91	65.7	0.83
6. Personnel Expenses	119.4	1.40	93.9	1.18	85.7	1.05	79.8	1.01
7. Other Non-Interest Expenses	34.3	0.40	25.4	0.32	23.3	0.28	18.0	0.23
8. Loan Loss Provisions	-21.5	-0.25	3.5	0.04	53.8	0.66	37.4	0.47
9. Other Provisions	1.7	0.02	0.0	0.00	5.9	0.07	1.7	0.02
<b>10. OPERATING PROFIT</b>	<b>178.3</b>	<b>2.09</b>	<b>188.9</b>	<b>2.38</b>	<b>125.4</b>	<b>1.53</b>	<b>116.8</b>	<b>1.48</b>
11. Exceptional Items	-60.9	-0.71	37.2	0.47	82.3	1.01	n.a.	-
<b>12. NET INCOME</b>	<b>117.4</b>	<b>1.38</b>	<b>226.1</b>	<b>2.85</b>	<b>207.7</b>	<b>2.54</b>	<b>116.8</b>	<b>1.48</b>

### Ratio Analysis

#### AFRICAN DEVELOPMENT BANK

		31 Dec 2003	31 Dec 2002	31 Dec 2001	31 Dec 2000
		Original	Original	Original	Original
<b>I. PROFITABILITY LEVEL</b>					
1. Net Income/Equity (av.)	%	3.40	6.91	6.84	4.11
2. Net Income/Total Assets (av.)	%	1.29	2.66	2.35	1.30
3. Net Interest Revenue + Commitment Fees/Gross Loans (av.) post guarantees	%	3.57	3.68	3.28	2.74
4. Non-int. Exp./Net Interest Rev. + Other Operating Income	%	74.36	52.12	49.64	52.02
5. Income from Equity Investment/Equity Investment (av.)	%	n.a.	n.a.	n.a.	n.a.
6. Provision on Loans & Equity Part. & Guarantees/Gross Loans + Equity Investment (av.) & Guarantees	%	-0.34	0.06	0.88	0.57
<b>II. CAPITAL ADEQUACY</b>					
1. Internal Capital Generation	%	3.40	6.91	6.84	4.11
2. Outstanding Loans + Equity Invest. + guarantees /Subscribed Capital + Reserves	%	23.12	24.67	27.52	29.47
3. Capital/Risks - Tier 1 (Basle G10)	%	n.a.	n.a.	n.a.	n.a.
4. Capital/Risks - Total (Basle G10)	%	n.a.	n.a.	n.a.	n.a.
5. Equity/Total Assets	%	35.12	41.65	35.77	33.73
6. AAA-AA- Callable Capital/Callable Capital	%	37.65	37.21	37.17	37.88
7. Available Equity/Required Capital (including guarantees)	%	776.02	685.69	613.08	609.39
<b>III. LIQUIDITY</b>					
1. Liquid Assets & Marketable Debt Securities/Debt < 1 Year	%	475.92	416.64	144.64	277.06
2. Liquid Assets & Marketable Debt Securities/Total Assets	%	42.09	25.41	24.88	21.62
3. Liquid Assets + Marketable Debt Securities/Undisbursed Loans	%	233.35	123.18	103.28	98.92
<b>IV. ASSET QUALITY</b>					
1. Non Accrual Loans /Gross Loans	%	21.17	14.27	19.89	24.67
2. Loan Loss Reserves / Gross Loans	%	8.36	8.24	7.64	6.42
3. Allowance for Possible Loss/Equity Investment	%	9.83	9.90	10.59	7.56
Total reserves / Gross Loans, Equity Investment & Guarantees	%	8.40	8.30	7.60	6.30
4. Loan Loss Reserves/Non Accrual Loans	%	39.48	57.75	38.43	26.02
5. Loans to Investment Grade Borrowers/Gross Loans + Equity Investment	%	27.10	24.10	23.92	22.54
<b>V. LEVERAGE</b>					
1. Debt/Subscribed Capital + Reserves	%	25.52	19.39	22.90	24.68
2. Debt/Callable Capital	%	30.40	22.99	26.87	29.05
3. Net Income + Interest Paid/Interest Paid	%	154.53	188.91	160.17	134.90

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