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African Development Bank

Rating Rationale

The Aaa senior debt and Aa1 subordinated debt ratings of the African Development Bank (AfDB) primarily reflect the bank's healthy capital adequacy and strong membership support (particularly from non-regional members rated Aaa/Aa). In addition, the preferred-creditor status of the AfDB and the significant progress achieved in improving its financial operations in recent years support the rating. Moody's believes that these factors more than compensate for the loans in non-accrual status. In February 2003, due to the socio-political crisis in Côte d'Ivoire, the African Development Bank Group (the Bank Group) temporarily relocated from Abidjan, Côte d'Ivoire to Tunis, where it will remain for at least the next two years. The temporary relocation decision is to be reviewed every year to ascertain when the AfDB would be able to resume its operations in Abidjan.

Aims and Structure

The Bank Group provides substantial assistance to regional member countries in the form of lending and non-lending activities. The Bank group consists of the AfDB and two concessional windows, the African Development Fund (ADF) and the Nigerian Trust Fund (NTF). The goals of the Bank Group are to promote sustainable economic growth and reduce poverty in Africa.

- The **AfDB** was established in 1964 and its subscribed capital currently amounts to US\$29 billion.
- The **ADF**, established in 1974 as the soft lending window of the Bank group, is primarily financed by the 24 non-African countries that form part of its membership. (All African countries are members of the group as well as Canada, USA, 14 European Countries,¹ two Middle Eastern² countries, two South American countries³ and four countries in Asia⁴). Its cumulative resources total US\$16 billion following the additional fund injection of US\$ 3.5 billion in September 2002.
- The **NTF** is a special fund created in 1976 by agreement between the Bank and the Government of Nigeria to assist in the development efforts of low-income Regional Member Countries (RMCs) whose economic and social conditions and prospects require financing on nonconventional terms. On December 31 2002, total NTF resources amounted to US\$ 543.51 million.

Fulfilling its Mandate: Enhancing Development and Reducing Poverty

In December 2002, the boards of directors of the Bank group approved the Strategic Plan for 2003-2007. The Strategic Plan describes how the Bank intends to direct and execute its activities so as to maximise its contribution towards enhancing development and reducing poverty in the African continent. The Bank Group is therefore participating in diverse initiatives, such as the HIPC (Highly Indebted Poor Countries) debt relief initiative, NEPAD (New Partnership for Africa's Development), the Water Initiative, and is also involved in projects that are aimed at enhancing governance.

¹ Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

² Kuwait and Saudi Arabia

³ Argentina and Brazil

⁴ China, Korea, India and Japan.



The Water Initiative

The Bank group is at the forefront of the new Water Initiative, which could have a sustainable impact on long-term development on the African continent. Effectively, more than 80% of the continent's population does not currently have access to a safe supply of water and an even higher percentage of the population lacks adequate sanitation – a problem that is especially acute in rural areas. The lack of drinking water not only causes numerous diseases, but also impairs opportunities for schooling and productive activities as women and children spend most of their time collecting water. The lack of access to safe water and adequate sanitation will become an even greater concern as the African population is expected to continue growing very rapidly over the next 20 years. The current growth rate of African continent's population is 2.26% on average, and as high as 3% in certain areas.

The provision of access to clean water is an important element of the Bank Group's development strategy. The Water Initiative, which is still at a developmental stage, aims to provide access to drinking water and sanitation to 66%⁵ of the rural population by 2010, with the aim of raising this percentage to 80% by 2015. This project represents an investment of US\$ 1.4 billion per year up to 2010 and of US\$ 940 million after. Loans toward increasing water supply are already representing 7% of the Bank group cumulative operation which totalled US\$ 45 billion as of 31 December 2002.

Improved field presence

With the objective of better fulfilling its mandate, the Bank has enhanced its field presence by implementing a programme to establish 25 field offices. Four offices have so far been opened (Egypt, Ethiopia, Gabon and Nigeria). The Bank also has national programme offices (NPOs) in Cameroon, Chad, Sao Tome and Principe and Uganda, and negotiations for opening an office in South Africa are currently under way.

Financial Profile

Moody's rates the long-term senior debt of the AfDB Aaa as it is on par with other multilateral financial institutions such as the International Bank for Reconstruction and Development (IBRD, or World Bank) and the Asian Development Bank (ADB). In Moody's opinion, the solid capital base, shareholder support and preferred creditor status more than offset concerns regarding AfDB's asset quality.

Support by member countries underpins AfDB's Aaa rating

The most important factors underpinning the Aaa rating is the Bank's capital adequacy and the support for the institution by member countries, notably those rated Aa and Aaa. This support has been demonstrated repeatedly in terms of both regional and non-regional shareholders' willingness to provide capital replenishments to support the expansion of the Bank's operations, and also in terms of their callable capital commitment. About 10% of the Bank's subscribed capital is paid-in, again comparable to most of the other multilateral financial institutions. The remaining callable capital is a "full-faith" and credit obligation of each member country, and provides a substantial cushion in the unlikely event that AfDB were to encounter cash flow difficulties, which has never been the case. The most recent capital increase was approved in 1998. Further evidence of membership support is the conclusion in September 2002 of the ninth replenishment of the African Development Fund.

Callable capital exceeds the stock of borrowings outstanding and is a multiple of debt service obligations due over the next five years. The ratio of usable equity to net loans⁶ continued to increase during 2002, reaching the level of 46.3% compared to 41.5% in 2001. In addition, internal policies limit total borrowings to 80% of total callable capital and senior debt to 80% of the callable capital of non-borrowing members. At the end of 2002, these ratios were 23.0% and 41.7%, respectively, compared to 26.9% and 44.2% in 2001.

Conservative provisioning policy further supports credit rating

The AfDB's conservative provisioning policy is part of an integrated framework of prudent credit management policies that supports the Bank's rating. Since 1993, the Bank has maintained a programme of annual increase in the general provisioning rate. By the end of 2002, the accumulated provision rate reached 8.24% of outstanding public sector loans, near the higher end of the estimated range of expected losses in the public sector portfolio and total principal in arrears.

⁵ Currently, only 33% of the population has access to drinking water and sanitation.

⁶ Usable equity corresponds to paid-in capital, plus reserves plus the callable capital of Aa and Aaa rated member countries, while net loans correspond to disbursed and outstanding loans less accumulated provisions for loan losses.

Strong financial position and structure should guard against fluctuating arrear's level

At the end of 2002, the gearing ratio was 25.7%. The total value of all loans, guarantees and equity investments is limited to 100% of subscribed capital, reserves and net income.

The level of arrears and non-accrual loans of the bank may fluctuate in response to socio-political and macroeconomic conditions in the regional member countries. However, the financial position and structure of AfDB is sufficiently robust to withstand such changes, without impairing its ability to meet its commitments to its bondholders in a timely manner.

At the same time, however, the stock of arrears declined drastically from 61.9% of paid in capital in 2001 to 40.1% in 2002 as a result of the exceptional arrears clearance mechanism designed by the Bank for the Democratic Republic of Congo (DRC).⁷ Moreover, the Bank is in the initial stages of designing an approach to enable post-conflict countries to become eligible for HIPC debt relief. Nevertheless, due to the economic and political volatility of the African continent, we are expecting the percentage of loans in non-accrual status to remain relatively high.

Lending portfolio dominated by creditworthy borrowers...

Under the current credit policy policy, 15 African countries are currently able to borrow from the Bank. The remaining 38 countries, the poorest countries in the continent, have access to the concessional funds of the ADF.⁸

However, the countries that are the most eligible borrowers⁹ are relatively far from reaching their country's limits, with internal guidelines set at 15% on a risk-adjusted basis of the Bank's maximum sustainable portfolio. In this context, the Bank has been able to increase its lending to the most creditworthy of its borrowers by using an approach that emphasises the risk-bearing capacity of capital, by devising innovative financial products and by offering more competitive loan products. As a result of the new eligibility policy, the proportion of new loans to countries classified as bearing a very low to low risk has been on an increasing trend since 2000, while loans to countries classified as having a moderate, high or very high risk are decreasing.

...while 'Highly Indebted Poor Countries' Initiative is aimed at weaker borrowers

Other favourable developments for the Bank include the HIPC (Highly Indebted Poor Countries) initiative, which has thus far had a moderating influence on the Bank's arrears by encouraging both aspiring countries and countries already receiving debt assistance to maintain good debt service performance. Over time, the deployment of HIPC resources should bring (or keep) the AfDB's weaker borrowers current on their obligations, leading to an improvement in the credit quality of the Bank's loan portfolio.

Volume of loans approved has been rising steadily, reaching US\$1.2 billion in 2002

For 2002, US\$1.2 billion of new AfDB loans were approved, the highest level in eight years. The total amount of approved loans for the Bank Group in 2002 including HIPC reached US\$ 2.7 billion, thus maintaining the increasing trend that has started in 1999. However, we are not expecting the amount of approvals related to HIPC to increase as most (22) of the eligible African countries qualified for it as of 31 December 2002. The debt service of HIPC countries improved from 21.1% to 14.8% in 2002. Moreover, like other multilateral banks, the Bank Group is developing its co-operation and co-financing with Bretton Woods institutions, UN specialised agencies and bilateral agencies. In 2002, through co-financing, the Bank group mobilised US\$3 billion.

At December 2002, the AfDB's cumulative approvals of loans and grants amounted to over US\$ 45 billion. In order to mitigate credit risk, the Bank's portfolio is spread around different sectors all over the continent. The two largest sectoral concentrations are in agriculture and rural development and transport, with shares of 18.7% and 16.0%, respectively.

7 This mechanism, approved by the Board of Directors in June 2002, is part of an internationally co-ordinated effort to provide critical development assistance to the DRC in its rehabilitation efforts as it emerges from conflict. The exceptional arrears clearance mechanism approved for the DRC consists of four principal elements. First, the DRC's arrears with the ADF were cleared by a grant from ADF Donors. Second, part of the DRC's arrears with the AfDB were cleared by a combination of payments by the DRC, the SFM (supplementary financing mechanism) and Donor contributions. Third, the residual portion of the DRC's arrears with the AfDB was cleared through consolidation into a new 20-year facility on non-concessionary terms. Fourth, subject to qualification, debt relief on the consolidated facility will be provided to the DRC through a combination of internal AfDB resources and external Donor resources as part of the HIPC debt relief initiative.

8 Two countries have simultaneous access to the ADB and the ADF.

9 Only four countries are rated investment grade from among the 15 countries eligible to borrow on normal terms from the AfDB at present.

Private sector assistance continues to expand, having doubled since 1999

The AfDB has also sought to expand and strengthen its private sector activities, which were established in 1991 with the objective of broadening the scope of development assistance provided to regional member countries, in recognition of the important role of the private sector in the economic development process.

The volume of private sector lending has effectively doubled since 1999 and multiplied by 30 since the creation of the AfDB's private sector window in 1991. The approvals in 2002 amounted to 26% of cumulative loan approvals for the private sector. Reflecting the strategy of the AfDB private sector operations to reach small and medium scale enterprises through carefully identified local financial intermediaries, the financial sector constituted the single largest sector for private sector loans, with approximately 56% of total loans to the private sector. Moreover, in 2002, the AfDB launched the Public Private Partnership (PPP) initiative for Africa, a programme that highlights the importance of infrastructure development for growth. In order to continue to reduce its credit risk, the AfDB has also enhanced its supervision of loans to the private sector.

In Moody's view, continued loan growth will be necessary to help reduce the weight of non-accrual loans so as to improve the AfDB's earning potential and maintain the institution's relevance to shareholders.

Prudent Liquidity Policy and Funding

The Bank maintains a prudent liquidity policy, which stipulates that liquid assets must cover the loan's equivalent value of signed guarantees, undisbursed equity investments and private sector loans, plus 50% of debt service requirements and net loan disbursements for the coming two years. In 2002, liquid assets represented 46.3% of outstanding borrowing.

Over the years, AfDB has been fine-tuning its liquidity policy. Further refinements have been implemented broadly in line with those of other multilateral institutions in view of the recent evolution of the Bank's asset liability management practices, the new IT infrastructure and the new accounting standards. The two major changes include

- First, "held to maturity" investments with remaining maturities greater than one year are excluded from liquid assets.
- Second, the shortened time horizon and quarterly revision of the prudential minimum level of liquidity decrease concerns relating to refinancing risks.

For 2003, the Bank has planned to borrow around US\$3 billion through private placements, loans and public issues (AfDB has been issuing in different currencies). As of 31 December 2002, the borrowing portfolio after swaps amounted to US\$6.06 billion. AfDB has also been expanding its investor base by addressing specific investors' needs.

African Development Bank

Key Financial Statement Statistics (US\$ Mills.)

	1995	1996	1997	1998	1999	2000	2001	2002
Balance Sheet Summary								
Assets								
Liquid Assets	14,546	13,451	12,484	13,267	13,134	11,939	11,796	11,837
Gross Loans	2,400	2,076	1,784	2,010	1,722	2,424	2,720	2,803
Gross Equity Investments	10,225	9,899	9,256	9,520	9,309	8,554	8,126	8,113
Net Loans	205	198	189	199	235	233	224	247
Other	10,054	9,493	8,830	9,026	8,778	8,005	7,505	7,445
Liabilities								
Borrowings	1,716	1,277	1,254	1,537	1,869	728	727	673
Other	10,629	9,432	8,471	8,935	8,695	7,484	7,112	6,457
Capital and Reserves								
Paid-in Capital	9,198	8,409	7,385	7,582	7,168	7,015	6,549	6,057
Cumulative Exchange and Currency Adjustments	1,432	1,024	1,086	1,353	1,527	470	563	400
Reserves	3,917	4,018	4,013	4,332	4,439	4,455	4,685	5,380
Plus/minus Cum. Exchange Adjust. on Subscription	2,799	2,737	2,587	2,697	2,666	2,602	2,611	2,889
Less Paid-in Capital in Non-convertible Currency	-756	-736	-664	-744	-744	-713	-727	-811
Plus reserves and Net Income	1,421	1,473	1,514	1,730	1,814	1,856	1,903	2,302
Loan and Equity Loss Provisions	76	124	136	142	156	143	253	307
	376	420	440	508	547	567	645	693

Capital Structure Summary

Total Subscribed Capital	23,412	22,835	21,529	22,375	22,976	26,772	27,008	29,243
Less Total Callable Capital (CC)	20,564	20,043	18,885	19,610	20,264	24,144	24,375	26,341
(CC of Aaa/Aa Countries)	5,887	6,142	5,763	6,014	7,083	6,731	9,061	9,802
(CC of Investment Grade Countries)	7,193	7,212	6,696	6,951	8,067	7,667	11,647	12,599
+/- Net Overdue or Prepaid Subscriptions	-49	-55	-57	-69	-46	-25	-23	-13
Equals Paid-in Capital	2,799	2,737	2,587	2,697	2,666	2,602	2,611	2,889
Less Non Negotiable Instruments Rcvd Not Yet Due	306	228	155	119	103	79	79	79
Plus/minus Cum. Exchange Adjust. on Subscription	-442	-433	-386	-444	-442	-165	-163	-193
Less Paid-in Capital in Non-convertible Currency	168	162	152	162	158	150	145	157
Plus reserves and Net Income	1,559	1,714	1,812	2,079	2,215	2,018	2,236	2,684
Equals Usable Equity	3,443	3,628	3,705	4,050	4,178	4,226	4,461	5,145

Loan Portfolio Summary

Approved Loans	19,007	17,751	16,796	18,269	18,684	17,837	17,794	20,269
Less Undisbursed Balance	5,554	3,730	2,714	2,959	3,076	2,470	2,288	2,283
Equals Disbursed Loans	13,453	14,022	14,082	15,311	15,608	15,368	15,506	17,986
Less Repayments	3,228	4,122	4,826	5,790	6,299	6,815	7,381	9,873
Equals Loans Outstanding	10,225	9,899	9,256	9,520	9,309	8,553	8,126	8,113

Income Statement

Gross Income	907	900	841	731	727	704	717	666
Income on Loans	734	780	734	619	630	574	555	556
Income on Investments	142	92	83	94	82	119	152	101
Other	31	28	24	18	15	11	9	9
Gross Expenses	803	749	680	578	558	549	559	410
Interest and Financial Expenses	652	619	584	491	472	452	439	352
Provisioning for Loan and Equity Investment Losses	86	78	54	45	40	52	75	5
Administrative Expenses	58	45	38	37	41	40	38	44
Other	6	7	5	5	5	5	7	9
Net Income	105	150	161	152	169	155	158	257

Key Financial Ratios	1995	1996	1997	1998	1999	2000	2001	2002
Performance Statistics (%)								
Return on Total Assets	0.7	1.1	1.3	1.2	1.3	1.2	1.4	2.1
Return on Earning Assets	0.8	1.2	1.4	1.4	1.5	1.4	1.5	2.3
Return on Equity [1]	2.7	3.8	4.1	3.7	3.9	3.5	3.5	4.9
Interest on Loans/Loans Outstanding	6.8	7.6	7.7	6.7	6.7	6.5	6.8	6.6
Interest Coverage Ratio (x)	1.2	1.2	1.3	1.3	1.4	1.3	1.4	1.7
Loans in Non-accrual as % of Paid-in Capital	50.6	36.6	33.7	49.9	50.5	81.1	61.9	40.1
Capital Adequacy Ratios (%)								
Usable Equity as % Risk Assets	38.6	42.4	46.6	49.9	53.6	60.0	68.0	80.0
Usable Equity + CC of Aaa/Aa Members as % Total Loans Outstanding	91.2	98.7	102.3	105.7	121.0	128.1	166.4	184.2
Usable Equity + CC of Aaa/Aa Members as % Risk Assets	104.7	114.2	119.2	123.9	144.4	155.5	206.2	232.5
Usable Equity + CC of IG Members/Risk Assets	119.4	126.7	130.9	135.5	157.0	168.7	245.7	276.0
Liquidity Ratios (%)								
Liquid Assets (incl. Special Reserve)/Total Assets	16.5	15.4	14.3	15.2	13.1	20.3	23.1	23.7
Liquid Assets (incl. Special Reserve)/Total Borrowings	26.1	24.7	24.2	26.5	24.0	34.6	41.5	46.3
Liquid Assets (excl. Special Reserve)/Undisbursed Loans	37.0	46.1	52.6	54.8	43.2	82.7	102.4	122.8
Coverage of Debt Service (%)								
Liquid Assets as % CMLTD plus Interest Paid	184.4	99.4	179.5	123.7	162.6	190.3	116.0	273.0
Liquid Assets + Net Income + Interest Paid as % CMLTD + Interest Paid	241.4	135.9	253.0	164.8	223.3	237.0	141.5	332.3
Liquid Assets + Net Income + Interest Paid as % Interest Paid	491.4	462.8	439.3	525.2	499.6	682.2	755.2	970.0
Maturity Distribution of Outstanding Borrowings (% of Total)								
CMLTD	7.2	17.5	5.7	14.7	8.2	11.8	29.1	11.1
One Year	17.6	5.7	13.9	6.6	8.8	24.4	5.3	13.7
Two to Four	24.8	27.8	35.7	32.5	36.0	12.8	11.4	9.6
More than Four Years	50.4	49.0	44.7	46.2	49.9	50.9	54.2	66.1

[1] *Equity = Paid-in Capital + Reserves + Cumulative exchange Adjustment on subscriptions + Cumulative Currency translation adjustment + Accumulated Provision for Loan Losses + Net Income for the period*

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