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Analysis

SUPRANATIONAL

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African Development Bank

Rating Rationale and Structure

The Aaa debt rating assigned to the African Development Bank's ("AfDB"s or "Bank"s) senior debt and Aa1 rating assigned to its subordinated debt primarily reflect its healthy capital position and strong support from its member countries, which include highly rated non-regional members. The ratings are also sustained by AfDB's preferred-creditor status. The AfDB has consistently remained well within its internal borrowing capacity and lending limitations, which are reflected in the healthy capital adequacy and liquidity ratios. The AfDB's indicators of risk-adjusted assets are on a par with or compare favorably to those of other Aaa-rated multilateral institutions such as the World Bank, the Inter-American Development Bank and the Asian Development Bank.

Moody's believes that these strengths more than compensate for the Bank's overall challenging African political and economic environment. The HIPC (Heavily Indebted Poor Countries) initiative sponsored by the AfDB, the World Bank, the International Monetary Fund (IMF), and the donor community, provides debt relief to the countries that demonstrate a commitment to maintaining sound macro economic performances and debt service payments. The HIPC initiative, which forces countries to remain current on their debt service payments, greatly decreases the risk that the Bank faces from doing business in Africa. Additionally, since 1995, the Bank only lends to the most highly rated African countries, with the rest of the continent having access to the concessional resources from the African Development Fund as described below.

STRUCTURE AND STRATEGY

The AfDB Group consists of the AfDB and two concessional windows, the African Development Fund (ADF) and the Nigerian Trust Fund (NTF). AfDB was created in 1964 as a regional multilateral development bank to promote the economic development and social progress of its 53 regional member countries. As of 31 December 2004, the subscribed capital of the AfDB amounted to $33.5 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 are shareholders of the AfDB, including Canada, the USA, 14 European countries[1], two Middle Eastern countries[2], two South American countries[3] and four countries in Asia[4]. The NTF is a special fund created in 1976 by agreement between the Bank and the Government of Nigeria to provide development financing on terms between those of the AfDB and ADF primarily to the low-income Regional Member Countries (RMCs) of the Bank. Following an agreement with the Nigerian Government aimed at strengthening the operational effectiveness of the NTF, disbursements increased by more than 100% in 2004. As of 31 December 2004, total NTF resources amounted to $570 million.

The Strategic Plan for 2003-2007 describes how the Bank intends to run its activities so as to maximise its contribution towards enhancing development and reducing poverty in the African continent. In addition to its core activities, the Bank Group is participating in diverse initiatives, such as the HIPC debt relief initiative, NEPAD (New Partnership for Africa's Development), and Water Initiative. It is also involved in projects that are aimed at enhancing governance. More specifically, the Bank Group is supporting the Steering Committees of NEPAD by providing technical assistance in the areas of infrastructure development and banking and financial standards.

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

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Capital Adequacy, Gearing Ratios

RATINGS REFLECT HEALTHY CAPITAL ADEQUACY AND STRONG MEMBERSHIP SUPPORT

The key factor underpinning AfDB's Aaa rating is the support of highly rated member countries. Such support has been repeatedly demonstrated by the willingness and ability of both regional and non-regional shareholders to meet the Bank's capital replenishment needs to support the expansion of its operations. The most recent capital increase was approved in 1998.

Further evidence of membership support is the conclusion in December 2004 of the tenth replenishment of the African Development Fund (ADF-X), covering the 2005-2007 period. A total of $5.7 billion is to be made available for new loan and grant commitments over the 2005-2007 period. The fund's cumulative resources totaled US$18.9 billion at the end of 2004.

The structure of the Bank's subscribed capital consisting of 10% as paid-in capital and the balance as callable capital[5] similar to those of the other multilateral financial institutions. Callable capital far exceeds (3.5 times) the stock of borrowings outstanding that reached US$ 8.8 billion at the end of 2004. It is also a multiple of debt service obligations due over the next five years. The ratio of usable equity to risky assets continued to increase during 2004, reaching 101% at the end of the year from 60% at end-2000. The total amount of loans, guarantees and equity investments is limited to 100% of subscribed capital, reserves and net income. At the end of 2004, this ratio was 22.4% compared to 24% in 2003. All these ratios illustrate the continuous improvement of the Bank's financial profile.

The AfDB's conservative provisioning policy forms part of an integrated framework of prudent credit management policies that supports the Bank's ratings. Since 1993, the Bank has maintained a programme of annual increases in the general provisioning rate. By the end of 2004, accumulated provision on loans and equities reached $706 million. The risk capital, a measure of risk-bearing capacity, is projected to grow by an average of 3-4% per year. Nevertheless, the utilization of risk capital is projected to remain at levels between 50% and 60% with a moderate increase anticipated for the coming years following a sharp decrease in the past five years mainly due to loan prepayments. In addition to its conservative capital adequacy position, the Bank's bondholders are well protected by its prudent leverage ratios. Currently the Bank uses three leverage ceilings linked to its callable capital:

1. Total debt must not exceed 80% of the total callable capital.
2. Total senior debt must not exceed 80% of the callable capital of non-borrowing member countries.
3. Total debt must not exceed 100% of the Bank's usable capital. [6]

At the end of 2004, these ratios were 29.2%, 58%, and 61.7%, respectively, compared to 23%, 41.7%, and 41.9% at end-2002.

Asset Composition & Quality

ASSETS CENTERED ON THE AFDB'S MANDATE

Through its financial performance and risk-bearing capacity, the AfDB is able to offer efficient lending terms to its borrowers. After five years of contraction, the bank's loan portfolio is expected to grow by an average of 5-6% per year, led mainly by non-sovereign lending.

The Bank's total lending and grant operations, including HIPC, amounted to US$2.4 billion in 2004. Overall total approvals doubled compared to 2003, a year when debt relief approvals under HIPC were significantly lower. The 2004 operations continued to emphasize priority sectors such as agriculture and rural development, infrastructure (where this is a vital component of rural development or economic integration), and human capital, vocational training. Projects in infrastructure accounted for 46.1% of total lending in 2004, while operations in agriculture, rural development, water supply and sanitation represented an aggregate 10%.

IMPROVED FIELD PRESENCE

With the objective of better fulfilling its mandate, the Bank has embarked on a program to substantially enhance its field presence through the opening of field offices. The goal is to have a total of 25 offices operating by the end of 2006. Currently, there are 16 offices in operation.

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5. Callable capital is the unpaid portion of the Bank's subscribed capital subject to call from its members in the event of a need to meet its obligations on borrowed funds or for guarantees chargeable. The Bank has never made a call on capital.

6. The Bank's usable capital is the sum of paid-in capital in convertible currencies, reserves, and callable capital of countries rated Aa2 or better.

FOCUS ON DIRECT LENDING TO MOST CREDITWORTHY OF ELIGIBLE BORROWER COUNTRIES

The AfDB's credit policy directs the Bank's lending activities to borrowers with the highest creditworthiness. Currently, only the 15 most highly rated African countries are eligible to borrow from the Bank window while the remaining 38 African countries can obtain development assistance from the African Development Fund, one of Bank Group's concessional windows. Among the AfDB eligible countries, several are still relatively far from reaching their AfDB borrowing limits with internal guidelines set at 15% per country 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 takes into account the risk of the assets and the required amount of risk capital to support these assets by devising and offering innovative and more competitive financial products. As a result of the 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.

The decrease of the Bank's stock of arrears has been facilitated by the development of the HIPC initiative. The Bank's operating income is sensitive to the payment performances of borrowing countries with economic and institutional weaknesses in many African countries having led to payment delays. A borrower is placed under sanctions when a payment from that borrower is 30 days overdue. The Bank places all loans of a borrower country in non-accrual status when any loan payment due from that country is six months overdue. In 2004, the Bank approved an internationally coordinated mechanism to help eligible post-conflict countries come into the mainstream of development by clearing their arrears to the Bank Group, thereby setting the stage for such countries to benefit from HIPC debt relief assistance and, ultimately, fully re-engage with the development community and gain further support for their reconstruction efforts. Still, due to the difficult economic and political environment of the African continent, we expect the percentage of loans in non-accrual status to remain relatively more or less at its current level until the post-conflict assistance mechanism starts having the desired impact. However, the stock of arrears declined drastically from 61.9% of paid-in capital in 2001 to 50% in 2004 as a result of the exceptional arrears clearance mechanism designed by the Bank for the Democratic Republic of Congo[7] (DRC).

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. Nevertheless, fewer African countries reached HIPC decision point in 2004, with most of the remaining countries being either conflict affected or post-conflict countries.

Asset /Liability Management

Moody's views the African Development Bank as capable of withstanding the impact of adverse socio-political and macroeconomic conditions in its member countries. The level of the Bank's arrears and non-accrual loans may fluctuate due to the socio-political and macroeconomic developments in the region. However, we believe that AfDB's structure and its financial condition are sufficiently robust to withstand such changes, without impairing its ability to meet its commitments to bondholders in a timely manner. For example, in our view, the Bank would be able to withstand the impact of its two largest borrowing countries, Tunisia and Morocco, falling into non-accrual status.

The Bank is exploring various ways in which it could enhance its impact on development in Africa through the strategic use of its net income. One option would be to develop schemes aimed at assisting post-conflict countries in decreasing their arrears, as was achieved in the case of the Democratic Republic of the Congo.

The Bank has also developed an internal sovereign and non-sovereign credit risk rating framework which differs from but has some correlation to the rating scales of rating agencies. Based on its sovereign and non-sovereign credit risk methodology, the Bank determines ratings that are calibrated against expected losses. The capital adequacy policy establishes a cushion against a maximum level of unexpected losses. The capital adequacy framework is the tool used currently by the Bank for strategic decisions.

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 2004, the Bank Group mobilised a total of $3.1 billion through co-financing, implying a leverage of more than 2.3 times the Bank Group's resources.

7. *The mechanism aimed at clearing DRC's arrears and consolidating the amount due in a restructured 20-year loan that maintained the net present value of the constituent loans, was also designed to safeguard the preferred-creditor status of the Bank and to minimise the risk of moral hazard. The initiative resulted in a substantial reduction in the arrears of the Bank, 60% of which was due to DRC arrears. Moreover, the DRC reached its HIPC "decision point" and qualified for debt relief under the Initiative in July 2003.*

Borrowing and Liquidity

As of 31 December 2004 the borrowing portfolio, through private placements and public bond issues in various currencies, amounted to $8.8 billion and was stable compared to 2003. The AfDB has been able to diversify its investor base by addressing more fully the needs of investors and to lower its funding costs to levels comparable with other multilateral financial institutions.

The Bank maintains a prudent liquidity policy. In recent years, the AfDB has been fine-tuning its liquidity policy which is based on a prudential and an operational levels of liquidity. The prudential minimum liquidity level is computed every quarter based on the AfDB's one-year probable cash flow requirements as the sum of four components: the following year's net loan disbursement and debt service requirements, plus the loans' equivalent value of signed guarantees, and undisbursed equity investments. This sets the minimum liquidity level. On the other hand, the operating liquidity level is the sum of the prudential minimum liquidity level plus 50 per cent of the stock of undisbursed loans. Due to some substantial prepayments that occurred in recent years the liquidity level has recently reached historically high levels. In 2004, liquid assets represented 79% of outstanding borrowings compared to 50% in 2000.

Earnings Trends and Profitability

OPERATING INCOME COULD BE AFFECTED BY BORROWER PREPAYMENTS

AfDB's 2005 operating income is still expected to be strong - above $300 million. In 2004, the Bank's operating income amounted to $362 million compared to $265 million in 2003. Income was higher in 2004 due to a write back in provisions resulting in large part from an overall reduction in outstanding loans that, in turn, was primarily attributable to prepayments of certain sovereign-guaranteed loans. Prepayments of loans by borrowers amounted to about $2 billion between 2002 and 2004, reflecting the worldwide low interest rate environment. The pace of prepayment is moderating, however, as the pool of loans likely to be prepaid diminishes and worldwide interest rates start to rise.

Operating income is generally allocated as follows: one-third to increase the general reserves and two-thirds to boost allocations to development priorities, which include ADF and the HIPC Trust Fund. With the attention Africa is receiving in the world community, the Bank is expected to remain at the forefront of development efforts in the continent.

Rating History Senior Unsecured

Action	Date	Long-term Issuer Rating
Rating assigned	12/21/1994	Aaa

Related Research

Special Comments:

Moody's Sovereign Ratings: A Ratings Guide, March 1999 (43788)

A Quantitative Model for Local Currency Government Bond Ratings, September 2003 (79404)

A Quantitative Model for Foreign Currency Government Bond Ratings, February 2004 (81176)

Rating Methodology:

Piercing the Country Ceiling: An Update, January 2005 (91215)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Related Website

African Development Bank

http://www.afdb.org/

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African Development Bank

Key Financial Statement Statistics (US$ Mils.)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Balance Sheet Summary										
Assets	**14,546**	**13,451**	**12,484**	**13,267**	**13,134**	**11,939**	**11,796**	**11,837**	**15,635**	**16,304**
Liquid Assets	2,400	2,076	1,784	2,010	1,722	2,424	2,720	2,803	6,245	6,956
Gross Loans	10,225	9,899	9,256	9,520	9,309	8,554	8,126	8,113	8,340	8,111
Gross Equity Investments	205	198	189	199	235	233	224	247	271	279
Net Loans	10,054	9,493	8,830	9,026	8,778	8,005	7,505	7,445	7,643	7,412
Other	1,716	1,277	1,254	1,537	1,869	728	727	673	780	958
Liabilities	**10,629**	**9,432**	**8,471**	**8,935**	**8,695**	**7,484**	**7,112**	**6,457**	**9,665**	**10,081**
Borrowings	9,198	8,409	7,385	7,582	7,168	7,015	6,549	6,057	8,618	8,786
Other	1,432	1,024	1,086	1,353	1,527	470	563	400	1,047	1,295
Capital and Reserves	**3,917**	**4,018**	**4,013**	**4,332**	**4,439**	**4,455**	**4,685**	**5,380**	**5,970**	**6,223**
Paid-in Capital	2,799	2,737	2,587	2,697	2,666	2,602	2,611	2,889	3,222	3,438
Cumulative Exchange and Currency Adjustments	-756	-736	-664	-744	-744	-713	-727	-811	-887	-955
Reserves	1,421	1,473	1,514	1,730	1,814	1,856	1,903	2,302	2,768	2,868
Net Income	76	124	136	142	156	143	253	307	144	167
Loan and Equity Loss Provisions	376	420	440	508	547	567	645	693	724	706
Capital Structure Summary										
Total Subscribed Capital	**23,412**	**22,835**	**21,529**	**22,375**	**22,976**	**26,772**	**27,008**	**29,243**	**32,043**	**33,542**
Less Total Callable Capital (CC)	**20,564**	**20,043**	**18,885**	**19,610**	**20,264**	**24,144**	**24,375**	**26,341**	**28,802**	**30,089**
(CC of Aaa/Aa Countries)	5,887	6,142	5,763	6,014	7,083	6,731	9,061	9,802	10,713	11,197
(CC of Investment Grade Countries)	7,193	7,212	6,696	6,951	8,067	7,667	11,647	12,599	13,836	14,461
+/- Net Overdue or Prepaid Subscriptions	-49	-55	-57	-69	-46	-25	-23	-13	-18	-15
Equals Paid-in Capital	**2,799**	**2,737**	**2,587**	**2,697**	**2,666**	**2,602**	**2,611**	**2,889**	**3,222**	**3,438**
Less Non Negotiable Instruments Rcvd Not Yet Due	306	228	155	119	103	79	79	79	62	48
Plus/minus Cum. Exchange Adjust. on Subscription	-442	-433	-386	-444	-442	-165	-163	-193	-216	-229
Less Paid-in Capital in Non-convertible Currency	168	162	152	162	158	150	145	157	171	179
Plus reserves and Net Income	1,559	1,714	1,812	2,079	2,215	2,018	2,236	2,684	2,995	3,014
Equals Usable Equity	**3,443**	**3,628**	**3,705**	**4,050**	**4,178**	**4,226**	**4,461**	**5,145**	**5,768**	**5,996**
Loan Portfolio Summary										
Approved Loans	19,007	17,751	16,796	18,269	18,684	17,837	17,794	20,269	23,211	24,833
Less Undisbursed Balance	5,554	3,730	2,714	2,959	3,076	2,470	2,288	2,283	2,678	2,361
Equals Disbursed Loans	13,453	14,022	14,082	15,311	15,608	15,368	15,506	17,986	20,532	22,472
Less Repayments	3,228	4,122	4,826	5,790	6,299	6,815	7,381	9,873	12,193	14,361
Equals Loans Outstanding	**10,225**	**9,899**	**9,256**	**9,520**	**9,309**	**8,553**	**8,126**	**8,113**	**8,340**	**8,111**
Income Statement										
Gross Income	**907**	**900**	**841**	**731**	**727**	**704**	**717**	**666**	**636**	**686**
Income on Loans	734	780	734	619	630	574	555	556	480	477
Income on Investments	142	92	83	94	82	119	152	101	148	192
Other	31	28	24	18	15	11	9	9	8	17
Gross Expenses	**803**	**749**	**680**	**578**	**558**	**549**	**559**	**410**	**371**	**344**
Interest and Financial Expenses	652	619	584	491	472	452	439	352	326	309
Provisioning for Loan and Equity Investment Losses	86	78	54	45	40	52	75	5	-29	-34
Administrative Expenses	58	45	38	37	41	40	38	44	67	58
Other	6	7	5	5	5	5	7	9	7	11
Operating Income	**105**	**150**	**161**	**152**	**169**	**155**	**158**	**257**	**265**	**342**

African Development Bank

Key Financial Ratios

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Performance Statistics (%)										
Return on Total Assets	0.7	1.1	1.3	1.2	1.3	1.2	1.4	2.1	1.9	2.1
Return on Earning Assets	0.8	1.2	1.4	1.4	1.5	1.4	1.5	2.3	2.0	2.3
Return on Equity [1]	2.7	3.8	4.1	3.7	3.9	3.5	3.5	4.9	4.5	5.5
Interest on Loans/Loans Outstanding	6.8	7.6	7.7	6.7	6.7	6.5	6.8	6.6	5.7	5.8
Interest Coverage Ratio (x)	1.2	1.2	1.3	1.3	1.4	1.3	1.4	1.7	1.8	2.1
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	54.8	50.7
Capital Adequacy Ratios (%)										
Usable Equity as % Risk Assets	38.6	42.4	46.6	49.9	53.6	60.0	68.0	80.0	90.6	101.0
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	197.6	212.0
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	259.0	289.5
Usable Equity + CC of IG Members/Risk Assets	119.4	126.7	130.9	135.5	157.0	168.7	245.7	276.0	308.0	344.5
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	39.9	42.7
Liquid Assets (incl. Special Reserve)/Total Borrowings	26.1	24.7	24.2	26.5	24.0	34.6	41.5	46.3	72.7	79.2
Liquid Assets (excl. Special Reserve)/Undisbursed Loans	37.0	46.1	52.6	54.8	43.2	82.7	102.4	122.8	233.1	294.7
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	424.7	499.1
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	464.9	545.7
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	2094.9	2463.2
Maturity Distribution of Outstanding Borrowings (% of Total)										
CMLTD	7.2	17.5	5.7	14.7	8.2	11.8	29.1	11.1	13.3	12.4
One Year	17.6	5.7	13.9	6.6	8.8	24.4	5.3	13.7	7.4	7.2
Two to Four	24.8	27.8	35.7	32.5	36.0	12.8	11.4	16.6	11.6	24.4
More than Four Years	50.4	49.0	44.7	46.2	47.1	50.9	54.2	58.6	67.7	56.0

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