

## Credit Analysis

## African Development Bank

### Ratings

#### African Development Bank

##### Foreign Currency

Long-Term	AAA
Short-Term	F1+
Outlook	Stable

Individual Support	-
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### Financial Data

#### African Development Bank

	31 Dec 2004	31 Dec 2003
Total Assets (USDm)	15,549.8	14,848.9
Total Assets (UA*m)	10,012.7	9,992.7
Equity (UAm)	3,521.5	3,509.6
Net Income before IAS 39 (UAm)	219.9	178.3
Net RoA (%)	1.07	1.07
Net RoE (%)	3.05	2.80
Equity/Assets (%)	35.17	35.12
Available Equ./Required Cap. (x)	10.5	10.2

\* UA= unit of account

1 UA= 1 special drawing right (XDR)

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### Rating Rationale

- The African Development Bank's (AfDB) ratings are primarily based on the support from its member countries, its preferred creditor status, its high level of capitalisation and its conservative risk management policies.
- AfDB lending is restricted to only 15 "eligible" countries, including two that can also borrow from the African Development Fund (ADF). The ADF provides concessional funds – i.e. loans with low interest rates and long repayment periods – to the poorest countries not eligible for loans from the AfDB. These loans are funded by subscriptions from participants, mainly non-African countries.
- The Bank has significant credit risk exposure in view of the high risk profile of the majority of its African sovereign borrowers. Impaired loans amounted to 21.5% of outstanding loans at end-2004 (21.2% in 2003), a level considerably higher than for other multilateral development banks (MDBs). This is because of the default of Zimbabwe and Côte d'Ivoire, which together accounted for 60% of the Bank's arrears at end-2004. However, chronic arrears have been reduced thanks to a debt relief initiative funded by the donors' community (the Heavily Indebted Poor Countries (HIPC) Initiative) and by two arrears reduction schemes (one for the Democratic Republic of Congo and the other for post-conflict countries) funded by the Bank with participation from donors.
- Credit risk is mitigated by the Bank's preferred creditor status, which gives the bank priority over other lenders in the event of a borrower's default; this does not apply, however, to private sector exposures. AfDB has also improved loan loss coverage since 1995; at end-2004, loan loss reserves amounted to 8.6% of total loans, but only covered 40.1% of impaired loans.
- The Bank's loan portfolio has been contracting since the late 1990s. This reflects a shortage of viable public projects to finance. In addition, loan prepayments reached a record level in the last two years, owing to a decline in interest rates and competition from other development institutions and the financial markets. To reverse this trend, the Bank intends to develop its lending activities to the private sector, which accounted for only 6.1% of its total portfolio at end-2004.
- 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.
- The AfDB is strongly capitalised. Its ratio of usable equity to required capital stood at 10.5x at end-2004, ranking one of the highest among MDBs.

### Support

- The AfDB's capital is held by 77 member countries, 53 of which are African. Some 10.3% of the capital has been paid-in; the remaining shares could be called if the Bank were unable to honour its debt obligations. Some 40% of the Bank's capital is owned by non-African countries, most of which are highly-rated OECD countries. According to Fitch Ratings, there is no doubt that these countries would support the Bank in case of need.

### Rating Outlook and Key Rating Drivers

- The Bank's support from its member countries, strong capitalisation and conservative risk management are key rating drivers. No significant changes are expected in the short to medium term.

### Profile

- The 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 1,043 staff at end-2004. 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.
- The AfDB makes loans to sovereign or sovereign-guaranteed institutions to finance development projects and programmes in Africa. It is also involved, to a lesser but increasing extent, in supporting private sector activities through loans, guarantees and equity stakes. The ADF and the Nigerian Trust Fund (NTF) are managed by the AfDB, but are financially independent.

## ■ Profile

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

### Historical Background

The African Development Bank (AfDB), an MDB established in 1964 and headquartered in Abidjan (Côte d'Ivoire), is a member of the African Development Bank Group. The AfDB is mandated with financing economic and social development in Africa. In the early 1990s, the Bank faced an internal crisis that resulted in the replacement of 70% of the management team and a comprehensive reform of 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 10th such replenishment in December 2004.

In 2003, the growing political instability in Côte d'Ivoire forced the AfDB's Board of Governors to temporarily relocate operations to back-up facilities in Tunis (Tunisia). This is reviewable at the annual general meetings of the AfDB Group. On the basis of the most recent assessment, the Bank is not expected to return to Abidjan in the short term. In July 2005, Mr. Donald Kaberuka, who was then Minister of Finance and Economic Planning in Rwanda, was elected President of the Bank; he has taken over from Mr. Kabbaj, who had been appointed in 1995 and had completed his second term on 1 September 2005.

### Organisation

The Bank's President is elected by the Board of Governors for a term of five years (and a maximum of two terms). The Board of Governors is the ultimate decision-making body of the Bank. Among other things, it approves capital increases and the admission of new members, and it defines the Bank's strategy. It comprises one delegate for each member country, i.e. any country that holds shares in the AfDB's capital. The President of the Bank also chairs the Board of Directors (BoD). The 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 employed 1,043 staff at end-2004 (2003: 987).

### Activities

The AfDB's main role is to provide financing and technical assistance to regional (i.e. African) member countries. Non-regional member countries are not allowed to borrow funds from the Bank. They participate in the AfDB's capital and bring their support to the Bank, enabling it to raise resources at the lowest possible cost.

The Bank is in fact organised as a group comprising three entities: the AfDB, which provides loans, guarantees and equity stakes to 15 eligible countries (income *per capita* being the main eligibility criterion); the African Development Fund (ADF), which grants concessional loans – i.e. loans priced well below market rates – to countries that currently cannot borrow from the AfDB, and the Nigeria Trust Fund (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 Nigeria respectively – and provide loans under extremely favourable conditions. While managed by the AfDB, both the ADF and NTF are financially independent. The AfDB accounted for about half (45.7%) of the financing approved by the Group (excluding HIPC debt relief) in 2004. Assistance funded through ADF and NTF resources accounted for 53.8% and 0.5% of approved loans respectively in 2004.

Many of the AfDB's loans are made under co-financing arrangements. In 2004, 31 projects totalling UA2.85billion were co-financed; the Group's contribution amounted to 29.8% of these projects. This enables the Bank to share the risk among different partners, generally other development agencies; the participation of the Bank in a project also facilitates fund raising from local financial institutions.

The AfDB's commitments take various forms. Fitch distinguishes direct financing (loans and equity) from other forms of development assistance that are not reported on-balance sheet, such as debt relief – which takes the form of a reduction in debt servicing spread over the life of the loan – and guarantees, which are recorded off-balance sheet.

Project loans, the AfDB's principal product, accounting for 51.6% of direct financing in 2004, are channelled into agriculture, utilities, transport, industry, healthcare and education. Just under 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

## AfDB Approvals by Instrument (2000 – 2004)

(UA*m)	2004	2003	2002	2001	2000
Project Loans	417.0	565.6	689.9	568.4	402.2
Public	255.8	359.8	491.0	376.4	375.0
Private	161.2	205.8	198.9	192.0	27.2
Equity Investments	3.21	-	-	-	2.3
Policy-Based Loans	388.7	176.7	185.6	232.1	-
Emergency Aid	2.8	3.6	4.6	1.2	-
Total Direct Financing	808.6	745.8	880.1	801.7	404.6
HIPC Debt Relief**	707.8	-	188.0	174.9	173.9
Guarantees & Other	-	-	-	10.1	264.7
<b>Total</b>	<b>1,519.5</b>	<b>745.8</b>	<b>1,068.1</b>	<b>986.7</b>	<b>843.2</b>

\* 1 UA (Unit of Account) = 1 SDR (Special Drawing Right)

\*\* Net present value of the reduction in debt service granted to the beneficiary countries

Source: the AfDB's annual report

project's life. The Bank can cancel undisbursed loan balances for non-performing loans.

Financing granted to the private sector accounts for a small share of the Bank's portfolio (7.3% of gross equity stakes and outstanding loans at end-2004). More than half of private sector financing is credit lines to local banks; the remainder takes the form of project loans and equity stakes. The Bank restricts its commitments to private projects to one-third of total financing. Private sector financing has now become a strategic priority for the AfDB. After two years of significant increases, loans to the private sector dropped to 19.9% of direct financing approved in 2004 versus 27.6% in 2003. To boost activity, the Board of Directors has authorised the Bank to provide loans to public corporations without formal sovereign guarantees; in parallel, a new strategy for private sector operations was approved at end-2004.

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 and the EIB – and disbursement is generally conditional upon implementation of adjustment policies recommended by the IMF.

Debt relief is granted by the Bank mainly under the Heavily Indebted Poor Countries (HIPC) initiative. A new debt alleviation programme – the Post-Conflict Countries Facility (PCCF) – was introduced in 2004, and the Bank will also be involved in the debt reduction initiative launched in May 2005 by the G8 nations, which is still at the preliminary stage of discussions.

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 macroeconomic and financial policies. 32 African countries are eligible for assistance; so far 23 countries 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 between two and four years before the debt relief process becomes irrevocable (the “completion point”). At end-2004, 12 African countries had reached the completion point – Benin, Burkina Faso, Ethiopia, Ghana, Mali, Madagascar, Mauritania, Mozambique, Niger, Senegal, Tanzania and Uganda – and 11 countries were at the decision point. Subsequently two more – Rwanda and Zambia – have reached the completion point in 2005. African countries will receive debt relief through multilateral and bilateral donors. The AfDB Group's share, in net present value (NPV) terms, will total USD3.9bn (including debt relief granted to the Democratic Republic of the Congo (DRC) under the arrears clearance mechanism approved in 2002); debt relief approved for the 23 countries amounts to USD32.5bn in NPV terms, out of which USD680.9m had actually been granted at end-2004.

At end-2004, nine African countries potentially eligible for HIPC relief had still not reached the decision point, mainly because they have been unable to clear their arrears. An exceptional debt restructuring package was arranged in 2002, enabling the DRC to clear its arrears and reach the decision point. It is financed through contributions from donors and AfDB net income allocations, which are placed in an account separate from those of the AfDB, the “special Account for the DRC”. A similar facility, the PCCF, was created in 2004 to

## The AfDB's 10 Largest Shareholders at End-2004 (%)

<b>Total Non-African Countries</b>	<b>39.95</b>
USA	6.65
Japan	5.48
Germany	4.13
France	3.76
Canada	3.75
<b>Total African Countries</b>	<b>60.05</b>
Nigeria	9.12
Egypt	5.16
South Africa	4.07
Algeria	3.83
Côte d'Ivoire	3.75
<b>Total</b>	<b>100.00</b>

Source: the AfDB's annual report

enable countries facing civil war or post-conflict situations to clear their arrears and benefit from the commencement of reconstruction efforts and debt reduction under HIPC. The PCCF is funded by donors and allocations from the ADF's and AfDB's net income. The first two countries benefiting from the PCCF were the Republic of the Congo and Burundi.

### ■ Capital, Funding and Liquidity

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

#### Capital

The ownership of the Bank is controlled by 53 African countries, which hold 60% of subscribed capital. Nigeria, Egypt and South Africa are the AfDB's largest African shareholders. The remaining shares are owned by 24 non-regional member countries, most of which are highly-rated OECD countries. Following the 1999 increase in authorised capital, the share of non-African member countries has increased to 40%. This gives a blocking minority on the Board of Governors' General Assembly, where a majority of two-thirds is required.

At end-2004, subscribed capital totalled UA21.6bn. Like other MDBs, paid-in capital only accounts for a fraction (10.3% at end-2004) of subscribed capital. At end-2004, 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 for the 1999 capital increase (paid in eight equal instalments) from certain shareholders (UA10.1m in 2004 versus UA12.7m in 2003) should be deducted.

Like other MDBs, the AfDB is not subject to international banking regulations and, as a

consequence, does not have to publish standard capital ratios. The Bank uses its own capital adequacy measures, which are defined by its management and approved by the Board of Directors. These ratios set the maximum lending level that the Bank can bear, in view of its level of capital (see *Funding*). Expected losses on assets are also calculated and regularly compared with "risk capital", defined by the Bank as the sum of net paid-in capital, net reserves and loan loss provisions.

To compare the capital adequacy of MDBs, Fitch has developed its own capital adequacy measures (see "Multilateral Development Banks: Rating Criteria and Industry Review" dated June 2005 and available on [www.fitchratings.com](http://www.fitchratings.com)), based on the analysis of the credit quality of both borrowers and shareholders. The agency computes the expected loss to the Bank on both its credit and equity operations – required capital – and compares it with the capital that the Bank can use to cover this loss, usable capital. This includes shareholders' equity, but also the callable capital subscribed by non-borrowing member countries with an investment grade rating. Fitch implicitly assumes that a credit loss large enough to sweep the Bank's equity could occur only if the borrowing countries were insolvent, and, hence, not in a position to respond to a capital call. The AfDB's ratio of usable capital to required capital is among the highest of the MDBs: at end-2004 it stood at 10.5 times versus 10.2 times at end-2003. This reflects the high level of capitalisation of the Bank.

#### Capital Adequacy Measures (Fitch Definition)

	2004	2003
Authorised Capital (UA*m)	21,870	21,870
Subscribed Capital (UAm)	21,598	21,564
Callable Capital (UAm)	19,375	19,383
Paid-in Capital (UAm)	2,223	2,181
Shareholders' Equity (UAm)	3,522	3,510
Usable capital (UAm)	11,162	11,151
Required Capital (UAm)	1,061	1,096
Usable Capital/Required Capital (x)	10.5	10.2

\* UA= unit of account

1 UA= 1 special drawing right (XDR)

Source: the AfDB's annual report; Fitch

#### Funding

The AfDB's operations are funded by equity or by borrowing on the capital markets. Thanks to its 'AAA' rating, it can raise resources at a very low cost. In 2004, the Bank raised a total of UA418m in the capital markets at an average cost of USD LIBOR minus 27.4 basis points. The Bank's funding is predominantly long term: the average maturity of funds raised in 2004 was 4.2 years. 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 BoD at 100% of usable capital, defined by the AfDB 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, though this does not constitute a Board-approved limit.

## The AfDB's Internal Prudential Ratios

Ratio (%)	Max.	2004	2003	2002
Total Debt/Usable Capital*	100.0	52.8	60.6	47.9
Total Debt/Callable Capital	80.0	29.16	29.8	23.0
Senior Debt/Callable Capital from Non-Borrowing Countries	80.0	58.0	59.2	41.7

\* Usable capital = Callable capital from 'AA/AAA' rated countries + Paid-in capital + Reserves (AfDB's definition)  
Source: the AfDB's annual report

## Liquidity

To maintain a high level of liquidity, the AfDB holds a large portfolio of liquid assets. It represents readily-available resources to meet daily cash requirements, but also funds loan and guarantee commitments when access to financial markets is restricted. The liquid assets portfolio consists of tradeable securities (51.8% of portfolio) and securities held to maturity (48.2%) in addition to interbank deposits. They are invested in hard currencies, primarily US dollars (USD), euro (EUR) and pounds sterling (GBP). Liquidity management follows a conservative set of rules. They require 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.

The Bank's liquid asset portfolio reached an historical peak in 2004: it increased to UA4.7bn, from UA4.5bn in 2003, and accounts for 44.8% of total assets (vs 42.1% in 2003). This is because of significant loan prepayments, which reached record levels in 2004.

## The AfDB's 10 Largest Loan Exposures (2003-2004)

	2004		2003	
	UAm	%	UAm	%
Tunisia**	1,210.5	23.2	1,157.2	20.6
Morocco**	683.5	13.1	595.7	10.6
Nigeria*	425.6	8.1	491.8	8.8
Côte d'Ivoire	360.7	6.9	359.7	6.4
DRC	343.5	6.6	346.7	6.2
Algeria**	296.2	5.7	347.9	6.2
Egypt**	241.3	4.6	240.6	4.3
Gabon**	216.1	4.1	183.3	3.3
Zimbabwe*	192.9	3.7	204.0	3.6
South Africa**	154.8	3.0	131.8	2.3
<b>Sub-Total</b>	<b>4,125.1</b>	<b>79.0</b>	<b>4,058.7</b>	<b>72.3</b>
Other Loans	1,097.4	21.0	1,553.5	27.7
<b>Total</b>	<b>5,222.5</b>	<b>100.0</b>	<b>5,612.2</b>	<b>100.0</b>

\* Countries eligible for both AfDB and ADF loans

\*\* Countries eligible for AfDB loans

Source: the AfDB's annual report

## ■ Risks

- **Significant exposure to credit risk and loan concentration**
- **Decrease in arrears as a result of debt reduction initiatives**

### Credit Risk

The AfDB's assets predominantly consist of loans; equity stakes only accounted for 1.3% of financings at end-2004. A large share of loans is extended to sovereign borrowers, and private sector loans accounted for only 6.1% of total lending at end-2004. The AfDB's loan portfolio carries significant credit risk, 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-2004, only two (Tunisia and South Africa) of the 10 largest borrowers were rated investment grade.

As is the case with MDBs operating in developing countries, the loan portfolio is marked by a high level of concentration. At end-2004, the 10 largest exposures accounted for 84.1% of total sovereign loans and 79.0% of the AfDB's entire loan portfolio. North African countries alone (Algeria, Egypt, Morocco and Tunisia) made up 46.6% of the total.

Since 1995 the AfDB's loans are limited to 15 "eligible" countries<sup>1</sup>. This includes two countries – Nigeria and Zimbabwe – that qualify for loans from both the AfDB and ADF. Other nations only have access to concessional financing from the ADF. Two

<sup>1</sup> Algeria, Botswana, Egypt, Equatorial Guinea, Gabon, Libya, Mauritius, Morocco, Namibia, Nigeria, Seychelles, South Africa, Swaziland, Tunisia and Zimbabwe.

## Arrears on Sovereign Loans (2000 to 2004)

(UAm)	2004	2003	2002	2001	2000
Angola					26.7
Burundi	4.1	9.4	6.8	7.3	4.8
Central African Republic	4.1	3.8	2.4	3.2	3.0
Comoros	12.5	12.0	6.4	10.5	9.9
Republic of the Congo	24.1	99.3	138.0	77.2	61.7
Côte d'Ivoire	154.1	77.3	-	44.5	28.5
DRC	-	-	347.9	600.8	569.4
Gabon					29.9
Liberia	119.4	117.9	41.6	114.6	110.0
Seychelles	19.7	16.3	20.0	7.8	3.5
Somalia	9.6	9.1	3.7	7.8	7.6
Sudan	61.3	59.0	59.6	45.4	38.2
Zimbabwe	165.9	142.2	204.0	80.5	32.8
Others	7.1	0.5	-	5.5	7.5
<b>Total</b>	<b>581.9</b>	<b>546.8</b>	<b>830.4</b>	<b>1,005.0</b>	<b>933.5</b>

Source: the AfDB's annual report

out of the 15 eligible for AfDB loans (Seychelles and Zimbabwe) are currently in default.

The bulk of the risks lie in the loans granted prior to 1995 to countries in conflict situations and in chronic arrears, such as the DRC, the Republic of the Congo, Liberia and Sudan. As principal and interest payments became due, arrears continued to build up, and impaired loans (i.e. loans recorded with non-accrual status) peaked at 24.6% of total loans in 2000, a level considerably higher than that for other 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. Principal and interest due were consolidated in two restructured 20-year loans, with an NPV equal to that of the consolidated loans (which means that no loss has been incurred by the Bank). In 2003, the DRC qualified for debt relief under the HIPC Initiative. In 2004, the creation of the PCCF enabled the Bank to partly clear the arrears of Burundi and the Republic of the Congo.

Although the Bank's non-accrual loans have declined significantly, they still accounted for 21.5% of outstanding loans at end-2004. However, loans to the DRC still have non-accrual status, though arrears have been cleared; non-accrual loans excluding the DRC made up 14.9% of outstanding loans. Since 2000, the main cause of the arrears was the default of two large borrowers, Zimbabwe and Côte d'Ivoire. This diluted the benefits drawn from the HIPC Initiative and the schemes put in place to clear chronic arrears. No significant repayment is expected in the short term, in view of the political situations in both countries. In contrast, the PCCF should help the

Bank reduce its chronic arrears, which should allow a reduction in non-accrual loans in the future.

The AfDB's credit risk exposure is mitigated by the Bank's preferred creditor status on public sector loans, which gives it priority over other creditors in the event of a sovereign default. Preferred creditor status does not apply, however, to private sector loans. The Bank applies stringent rules when principal or interest is more than 30 days overdue by ceasing disbursement (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 status.

The AfDB makes general provisions for statistically-probable losses and specific provisions where a permanent impairment can be reasonably assessed. Despite a steady build-up in provisions since 1995, which brought loan loss reserve coverage to 8.6% of gross loans at end-2004, provisions only covered 40.1% of impaired loans in 2004 (39.5% in 2003). In 2005, provisions for impaired loans will be significantly reduced, as they will be calculated on an incurred loss (and not expected loss) basis, in application of International Financial Reporting Standards (IFRS). This will dilute loan loss coverage ratios. The Bank will transfer provisions into reserves, so as not to reduce its risk capital.

## Non-Accrual Loans and Provisions (2000 to 2004)

(UAm)	2004	2003	2002	2001	2000
Non-Accrual Loans	1,121.5	1,188.2	851	1,286	1,620
Balance-Sheet Provisions	450	469	492	494	422
Non-Accrual Loans/Loans (%)	21.5	21.2	14.3	19.9	24.6
LL Reserves/Loans (%)	8.6	8.4	8.2	7.6	6.4
LL Reserves/Non-Accrual Loans (%)	40	39	58	38	26

Source the AfDB's annual report and Fitch calculations

## Market Risk

The AfDB's exposure to market risk is minimal, as the Bank does not view market activities as a profit-maximising activity. The Bank employs a strategy of currency and interest rate matching across the balance sheet. A large share of the Bank's assets consist of floating and variable rate loans and investment securities; they are mainly funded by borrowings that, after swapping, bear either a floating rate or a variable rate. Fixed-rate loans and equity stakes are funded by shareholders' equity. Currency mismatching is also kept to a minimum: loans are denominated in convertible currencies (USD, EUR, GBP, Swiss franc (CHF) and Japanese

yen (JPY)) and are matched in the relevant currency, using currency swaps extensively. The main source of market risk for the Bank lies in prepayments from borrowers. In the last three years, a number of borrowers prepaid their loans, in particular, the fixed-rate loans, which had been granted before or during the early 1990s and carry a high interest rate; prepayments peaked at UA541.8m in 2004, equivalent to 10.4% of outstanding loans.

## Operational Risk

The AfDB has a business continuity services contract with a Paris provider to ensure data security and that critical servicing, including debt servicing and payments to creditors, is 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

- **High level of prepayments affected revenue in 2004**
- **Growth in lending is slower than expected, owing to insufficient viable projects to finance in Africa**

The AfDB presents its financial statements in accordance with IFRS. The adoption of IAS39 (which requires the recognition of fair values of derivatives instruments on the balance sheet) has increased earnings volatility. This is not justified as, if a derivatives instrument is used as a hedge, positive adjustments will offset negative influences over the life of the instrument. Fitch reports profits and losses from non-trading derivatives as exceptional items, and bases the analysis of the Bank's performance on pre-IAS39 earnings.

## Performance

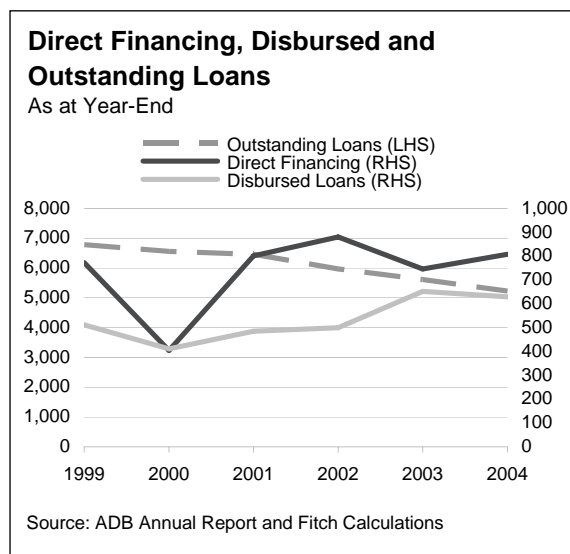
Like other MDBs, profitability is not one of the AfDB's primary objectives. However, the accumulation of profit is a means of increasing the Bank's equity base. In recent years, the Bank's return on credit operations, as measured by the ratio of net interest revenue and commitment fees to gross loans, liquid assets and guarantees, has been relatively stable; at 2.40% in 2004, it is relatively high compared with other MDBs. Earnings have not been affected by the slower than expected growth in lending and the contraction of the loans portfolio over the last four years. The combined effects of loan prepayments and the reduction in loan disbursements had a negative impact on interest income (about -4.6%), as a significant proportion of loans repaid were old fixed-rate loans bearing a high interest rate. This was offset by an increase in revenue from the liquid asset portfolio (+23.9%), which generated a return of 2.99% in 2004.

Pre-IAS39 earnings increased by 23.3% in 2004; this performance reflects declines in provisions, resulting from a contraction in the Bank's loan portfolio for the second year in a row, and a reduction in administrative expenditure compared with 2003. Administrative expenditure was exceptionally high in 2003, owing to additional one-off expenditure relating to the relocation of the Bank to Tunis in that year.

The cost of debt reduction and arrears clearance schemes does not appear to be negligible. While the cost of HIPC is relatively limited – USD124m, or less than 5% of equity, spread over the life of HIPC Initiative – as it is mostly funded by donors and through the ADF, the cost of debt relief for the DRC and post-conflict countries will be not be insignificant. The AfDB has allocated UA99m from its reserves in 2004 to fund these two schemes, which account for the bulk of 2004 net income (UA107m). However, these costs will be offset by the fact that those countries will now be, in principle, able to honour their debt servicing to the Bank.

## Prospects

Lending activity had been growing at slow pace in recent years and is now declining. This has been aggravated by record prepayment levels over the last three years. In 2004, loans disbursements decreased by 3.4%, and the loan portfolio shrank by 6.9%. Approved project loans fell markedly (-26.3%) in 2004 and the observed increase in approved loans was mainly attributable to an unusually high level of policy loans. This reflects a shortage of viable public projects to finance and competition from other development institutions. The move towards non-sovereign guaranteed loans and the Bank's new private sector strategy is aimed at reversing this



trend. In the short to medium term, loan growth will remain constrained by the Bank's credit policy, which limits public lending to only 15 countries. However, prepayments should decrease significantly, as most of the loans carrying high interest rates have been prepaid. For the Bank to avoid a continued contraction in its loan portfolio, it intends to become more aggressive in the private sector loan market.

These activities will be developed, and the Bank will hire more staff and open up new offices in some African countries. It will also target commercially-oriented publicly-owned entities and enclave projects. However, this strategy will induce higher administrative and staff expenditure, and may lead to more risk taking.

Balance Sheet Analysis  
AFRICAN DEVELOPMENT BANK

	31 déc 2004				31 déc 2003		31 déc 2002		31 déc 2001	
	Year End USDm	Year End XDRm	As % of Assets	Average XDRm	Year End XDRm	As % of Assets	Year End XDRm	As % of Assets	Year End XDRm	As % of Assets
	Original	Original	Original	Original	Original	Original	Original	Original	Original	Original
<b>A. LOANS</b>										
1. Loans made through Banks	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
2. To/Guaranteed by Public Institutions	7 615,2	4 903,5	48,97	5 143,7	5 383,9	53,88	5 798,8	71,24	6 387,8	72,50
3. To Private Sector	495,4	319,0	3,19	273,7	228,4	2,29	168,9	2,08	78,0	0,89
4. Trade Financing Loans	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
5. Other Loans	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
6. Loan Loss Reserves (deducted)	699,0	450,1	4,50	459,6	469,1	4,69	491,7	6,04	494,2	5,61
<b>TOTAL A</b>	<b>7 411,6</b>	<b>4 772,4</b>	<b>47,66</b>	<b>4 957,8</b>	<b>5 143,2</b>	<b>51,47</b>	<b>5 476,0</b>	<b>67,28</b>	<b>5 971,6</b>	<b>67,78</b>
<b>B. OTHER EARNING ASSETS</b>										
1. Deposits with Banks	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
2. Securities held for Sale & Trading	3 576,4	2 302,9	23,00	2 300,0	2 297,1	22,99	805,7	9,90	2 099,2	23,83
3. Investment Debt Securities - (incl. other invest.)	3 317,9	2 136,4	21,34	1 989,5	1 842,6	18,44	1 173,7	14,42	n.a.	-
4. Equity Investments	272,1	175,2	1,75	169,7	164,2	1,64	163,8	2,01	159,6	1,81
<b>TOTAL B</b>	<b>7 166,4</b>	<b>4 614,5</b>	<b>46,09</b>	<b>4 459,2</b>	<b>4 303,9</b>	<b>43,07</b>	<b>2 143,2</b>	<b>26,33</b>	<b>2 258,8</b>	<b>25,64</b>
<b>C. TOTAL EARNING ASSETS (A+B)</b>	<b>14 578,0</b>	<b>9 386,9</b>	<b>93,75</b>	<b>9 417,0</b>	<b>9 447,1</b>	<b>94,54</b>	<b>7 619,2</b>	<b>93,61</b>	<b>8 230,4</b>	<b>93,41</b>
<b>D. FIXED ASSETS</b>	<b>27,3</b>	<b>17,6</b>	<b>0,18</b>	<b>19,2</b>	<b>20,8</b>	<b>0,21</b>	<b>16,3</b>	<b>0,20</b>	<b>17,9</b>	<b>0,20</b>
<b>E. NON-EARNING ASSETS</b>										
1. Cash and Due from Banks	68,0	43,8	0,44	55,2	66,5	0,67	89,2	1,10	93,0	1,06
2. Other	876,5	564,4	5,64	511,4	458,3	4,59	414,7	5,09	469,5	5,33
<b>F. TOTAL ASSETS</b>	<b>15 549,8</b>	<b>10 012,7</b>	<b>100,00</b>	<b>10 002,7</b>	<b>9 992,7</b>	<b>100,00</b>	<b>8 139,4</b>	<b>100,00</b>	<b>8 810,8</b>	<b>100,00</b>
<b>G. SHORT-TERM FUNDING</b>										
1. Bank Borrowings (< 1 Year)	14,4	9,3	0,09	61,6	113,9	1,14	n.a.	-	n.a.	-
2. Securities Issues (< 1 Year)	1 085,1	698,7	6,98	734,3	769,9	7,70	496,5	6,10	1 515,6	17,20
3. Other (incl. Deposits)	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
<b>TOTAL G</b>	<b>1 099,5</b>	<b>708,0</b>	<b>7,07</b>	<b>795,9</b>	<b>883,8</b>	<b>8,84</b>	<b>496,5</b>	<b>6,10</b>	<b>1 515,6</b>	<b>17,20</b>
<b>H. OTHER FUNDING</b>										
1. Bank Borrowings (> 1 Year)	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
2. Other Borrowings (incl. Securities Issues)	6 611,6	4 257,3	42,52	4 271,0	4 284,7	42,88	3 062,3	37,62	2 255,2	25,60
3. Subordinated Debt	1 089,0	701,2	7,00	712,5	723,8	7,24	896,2	11,01	1 440,4	16,35
4. Hybrid Capital	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
<b>TOTAL H</b>	<b>7 700,6</b>	<b>4 958,5</b>	<b>49,52</b>	<b>4 983,5</b>	<b>5 008,5</b>	<b>50,12</b>	<b>3 958,5</b>	<b>48,63</b>	<b>3 695,6</b>	<b>41,94</b>
<b>I. OTHER (Non-Int Bearing)</b>	<b>1 280,8</b>	<b>824,7</b>	<b>8,24</b>	<b>707,8</b>	<b>590,8</b>	<b>5,91</b>	<b>294,2</b>	<b>3,61</b>	<b>447,8</b>	<b>5,08</b>
<b>J. GENERAL PROVISIONS &amp; RESERVES</b>	<b>n.a.</b>	<b>n.a.</b>	<b>-</b>	<b>n.a.</b>	<b>n.a.</b>	<b>-</b>	<b>n.a.</b>	<b>-</b>	<b>n.a.</b>	<b>-</b>
<b>L. EQUITY</b>										
1. Preference Shares	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
2. Subscribed Capital	33 541,8	21 597,9	215,71	21 580,8	21 563,7	215,79	21 509,9	264,27	21 491,0	243,92
3. Callable Capital	-30 089,0	-19 374,6	-193,50	-19 378,7	-19 382,8	-193,97	-19 375,5	-238,05	-19 395,2	-220,13
4. Arrears/Advances on Capital	-292,3	-188,2	-1,88	-193,9	-199,5	-2,00	-208,8	-2,57	-210,4	-2,39
5. Paid in Capital (memo)	3 452,8	2 223,3	22,20	2 202,1	2 180,9	21,82	2 134,6	26,23	2 096,1	23,79
6. Reserves (incl. Net Income for the year)	2 308,4	1 486,4	14,85	1 507,3	1 528,2	15,29	1 464,6	17,99	1 266,4	14,37
<b>TOTAL L</b>	<b>5 468,9</b>	<b>3 521,5</b>	<b>35,17</b>	<b>3 515,6</b>	<b>3 509,6</b>	<b>35,12</b>	<b>3 390,2</b>	<b>41,65</b>	<b>3 151,8</b>	<b>35,77</b>
<b>M. TOTAL LIABILITIES &amp; EQUITY</b>	<b>15 549,8</b>	<b>10 012,7</b>	<b>100,00</b>	<b>10 002,7</b>	<b>9 992,7</b>	<b>100,00</b>	<b>8 139,4</b>	<b>100,00</b>	<b>8 810,8</b>	<b>100,00</b>
Exchange Rate		USD1 = XDR 0.6439			USD1 = XDR 0.6730		USD1 = XDR 0.7357		USD1 = XDR 0.7957	

## Income Statement Analysis

### AFRICAN DEVELOPMENT BANK

	31 déc 2004		31 déc 2003		31 déc 2002		31 déc 2001	
	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	424,1	4,50	414,9	4,86	463,0	5,84	555,0	6,78
2. Interest Paid	195,6	2,08	215,3	2,52	254,3	3,21	345,2	4,22
<b>3. NET INTEREST REVENUE</b>	<b>228,5</b>	<b>2,43</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>
4. Other Operating Income	6,7	0,07	7,1	0,08	20,2	0,25	9,8	0,12
5. Other Income	111,1	1,18	105,5	1,24	82,8	1,04	74,5	0,91
6. Personnel Expenses	115,6	1,23	119,4	1,40	93,9	1,18	85,7	1,05
7. Other Non-Interest Expenses	32,5	0,35	34,3	0,40	25,4	0,32	23,3	0,28
8. Loan Loss Provisions	-18,2	-0,19	-21,5	-0,25	3,5	0,04	53,8	0,66
9. Other Provisions	-3,5	-0,04	1,7	0,02	0,0	0,00	5,9	0,07
<b>10. OPERATING PROFIT</b>	<b>219,9</b>	<b>2,34</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>
11. Exceptional Items	-112,5	-1,19	-81,6	-0,96	37,2	0,47	82,3	1,01
<b>12. NET INCOME</b>	<b>107,4</b>	<b>1,14</b>	<b>96,7</b>	<b>1,13</b>	<b>226,1</b>	<b>2,85</b>	<b>207,7</b>	<b>2,54</b>

## Ratio Analysis

### AFRICAN DEVELOPMENT BANK

		31 déc 2004	31 déc 2003	31 déc 2002	31 déc 2001
		Original	Original	Original	Original
<b>I. PROFITABILITY LEVEL</b>					
1. Net Income/Equity (av.)	%	3,05	2,80	6,91	6,84
2. Net Income/Total Assets (av.)	%	1,07	1,07	2,66	2,35
3. Net Interest Revenue + Commitment Fees/Gross Loans (av.) + Liquid Assets (av.) + Average Guarantees (av.)	%	2,40	2,32	2,55	2,51
4. Non-int. Exp./Net Interest Rev. + Other Operating Income	%	62,97	74,36	52,12	49,64
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 (av.) + Equity Investment (av.) & Guarantees (av.)	%	-0,39	-0,33	0,05	0,88
<b>II. CAPITAL ADEQUACY</b>					
1. Internal Capital Generation	%	3,05	2,80	6,91	6,84
2. Outstanding Loans + Net Equity Invest. + Net Guarantees /Subscribed Capital + Reserves	%	21,56	23,04	24,59	27,43
3. Equity/Total Assets	%	35,17	35,12	41,65	35,77
4. AAA-AA- Callable Capital/Callable Capital	%	37,66	37,65	37,21	37,17
5. Broad Capital/Required Capital	%	1 809,67	1 740,01	1 558,08	1 418,20
6. Usable Capital/Required Capital	%	1 052,16	1 017,47	n.a.	n.a.
<b>III. LIQUIDITY</b>					
1. Liquid Assets & Marketable Debt Securities/Debt < 1 Year	%	633,21	475,92	416,64	144,64
2. Liquid Assets & Marketable Debt Securities/Total Assets	%	44,77	42,09	25,41	24,88
3. Liquid Assets + Marketable Debt Securities/Undisbursed Loans and Equity	%	294,09	233,35	123,18	103,28
<b>IV. ASSET QUALITY</b>					
1. Non Accrual Loans /Gross Loans	%	21,47	21,17	14,27	19,89
2. Loan Loss Reserves / Gross Loans	%	8,62	8,36	8,24	7,64
3. Equity Loss Reserves /Equity Investment	%	2,34	9,83	9,90	10,59
4. Total reserves / Gross Loans, Equity Investment & Guarantees	%	8,40	8,40	8,30	7,60
5. Loan Loss Reserves/Non Accrual Loans	%	40,13	39,48	57,75	38,43
6. Loans to Investment Grade Borrowers/Gross Loans Loans	%	26,78	23,69	20,77	24,57
<b>V. LEVERAGE</b>					
1. Debt/Equity	%	160,91	167,89	131,41	165,34
2. Debt/Subscribed Capital + Reserves	%	24,55	25,52	19,39	22,90
3. Debt/Callable Capital	%	29,25	30,40	22,99	26,87
4. Net Income + Interest Paid/Interest Paid	%	154,91	144,91	188,91	160,17

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