

International
Credit Analysis

African Development Bank

Ratings

African Development Bank

Foreign Currency

Long-Term IDR* AAA
Short-Term IDR* F1+

Outlook Stable

* IDR - Issuer Default Rating

Financial Data

African Development Bank

	31 Dec 06	31 Dec 05
Total Assets (USDm)	18,513.7	16,543.7
Total Assets (UAm)*	12,311.6	11,575.0
Equity (UAm)	4,432.6	4,352.2
Pre-Derivative	162.3	244.9
Operating Profit (UAm)		
Net RoA (%)	0.46	0.69
Net RoE (%)	1.25	1.80
Equity/Assets (%)	36.00	37.60
Usable Capital/	18.33	14.44
Required Capital (x)		

* UA = unit of account; 1 UA = 1 special drawing right (XDR)

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■ Rating Rationale

- The ratings of African Development Bank (AfDB) are primarily based on the support from its member countries, its high level of capitalisation and its conservative risk management policies.
- As with other regional multilateral development banks (MDBs) that lend to developing countries, the bank is highly exposed to credit and concentration risk: at end-2006, its sovereign lending carried an average credit rating of 'B+' and the 10 largest borrowers accounted for 83.8% of the loan book. Such a challenging operating environment translated into an unusually high level of impaired loans for an MDB, standing at 12.7% of the bank's loan book at end-2006, with arrears at 13.9%.
- AfDB's portfolio is affected by two conflicting trends. On the one hand, its asset quality is showing signs of improvement, notably as a result of the debt relief initiatives funded by the donor community – the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) – and of arrears reduction schemes. On the other, chronic arrears from a few large borrowers have hampered efforts to clean up the bank's loan portfolio.
- The questionable historical performance of the bank's loan book and its concentrated nature are, however, largely offset by an excellent level of capitalisation. At end-2006, Fitch Ratings' ratio of usable capital to required capital was 18.3x (2005: 14.4x), benefiting essentially from a 4.0% decrease in outstanding loans. AfDB's public-sector lending has in fact contracted consistently since 1999, reflecting a shortage of viable public projects to finance, competition from other development institutions and some member countries' easier access to capital markets.
- In an effort to reach new borrowers, AfDB is turning to non-sovereign financing, which accounted for only 6.0% of total lending at end-2006. Fitch considers the bank's prudential framework to be suitable at current levels of its ongoing lending shift: AfDB's capitalisation, gearing and liquidity ratios all compared very favourably with those of other regional MDBs at end-2006.

Support

- AfDB's capital is held by 77 member countries, 53 of which are African. Some 10.6% of the capital has been paid in; the remaining shares could be called in the event of the bank being 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. Fitch believes these countries would provide additional support to AfDB if necessary.

■ Rating Outlook and Key Rating Drivers

- The rating Outlook is Stable. Downward pressure on the rating could arise from deterioration in its specific drivers: unexpected weakening in shareholders' support, a significant decline in capitalisation and more accommodating risk management policies. Fitch deems those changes unlikely in the short to medium term.

■ Profile

- AfDB is an MDB created to assist the economic and social development of its 53 regional member countries (RMCs). It is headquartered in Abidjan (Côte d'Ivoire) and employed 1,044 staff at end-2006.
- Only 15 RMCs are eligible for AfDB loans. Non-eligible states can have access to concessional resources through the African Development Fund (ADF) and the Nigerian Trust Fund (NTF), both of which are managed by AfDB but are financially independent.

■ Profile

- **Extends financing to its developing member countries in Africa**
- **Lending is overwhelmingly sovereign-guaranteed**

Background: AfDB is an MDB established in 1964 and a member of the African Development Bank Group. It is mandated with financing economic and social development in Africa. It is headquartered in Abidjan (Côte d'Ivoire), though in 2003 growing political instability in the country forced AfDB's board of governors to relocate operations temporarily to back-up facilities in Tunis (Tunisia).

Purposes: AfDB's main role is to provide financing and technical assistance to RMCs (i.e. African countries). Non-RMCs are not allowed to borrow funds from the bank. They participate in AfDB's capital and support the bank, enabling it to raise resources at the lowest possible cost. The 2003-2007 medium-term strategic plan, which was approved by the bank's board of governors in 2002, reasserts AfDB's focus on poverty reduction and productivity growth in RMCs. The plan also identifies the decentralisation of the institution's activities as a key organisational objective: as at end-2006, 22 of the 25 targeted field offices had been opened.

Governance: The bank's president is elected by the board of governors for up to two five-year terms. Donald Kaberuka, then minister of finance and economic planning in Rwanda, was elected president of the bank in July 2005. The board of governors is the bank's ultimate decision-making body. Among other things, it approves capital increases and the admission of new members, and defines the bank's strategy. The president of the bank also chairs the 18-member resident board of directors, which represents the 77 member countries and oversees operations and policy-making. Six directors represent non-African countries and 12 represent African nations. While decisions are taken by a two-thirds majority, members have the right to request a 70%-weighted majority. The bank employed 1,044 staff at end-2006.

Organisation: The African Development Bank Group comprises three entities: AfDB, which provides loans, guarantees and equity stakes to 15 eligible countries (income per capita being the main eligibility criterion); the ADF, which grants concessional loans – i.e. loans priced well below market rates – to countries that currently cannot borrow from AfDB; and the NTF, a fund set up with Nigeria to support the development efforts of low-income African nations. The NTF's 30-year term ended in April 2006 but the Nigerian authorities

Peer Group Analysis

As a regional MDB, AfDB distributes financing to emerging-market economies and its capital is shared between borrowing members – developing countries – and non-borrowing members – industrialised countries. Regional MDBs also include the Asian Development Bank (AsDB, 'AAA'/'F1+') and the Inter-American Development Bank (IADB, 'AAA'/'F1+'). Although it provides financing on a broader geographical scale, the International Bank for Reconstruction and Development (IBRD, 'AAA'/'F1+')¹ is a relevant comparator as it shares some features with regional MDBs, namely its shareholding structure and significant exposure to developing sovereigns.

granted one-year extensions of the agreement in May 2006 and March 2007, the latest running until 25 April 2008. While managed by AfDB, both the ADF and NTF are financially independent. AfDB accounted for about half (51.0%) of the group's total loan approvals in 2006. Unless otherwise stated, all information in this report relates to AfDB's financial operations.

Financial Operations

AfDB's commitments take various forms. Fitch distinguishes direct financing (loans, equity and guarantees) from other forms of debt relief instruments, which are not reported on its balance sheet.

Public-Sector Lending

A predominant majority of AfDB's financing is extended to or guaranteed by governments. At end-2006, public-sector lending represented 91.9% of the bank's total outstanding portfolio when cumulating lending and equity operations (2005: 92.2%).

- **Project loans**, AfDB's principal product, are aimed at supporting specific productive assets in sectorally identifiable activities. Project lending accounted for 54.9% of total loans outstanding at end-2006. Just fewer than 90% of project loans take the form of financing government-guaranteed projects, advances to other public-sector entities and credit lines to public financial institutions.
- **Policy-based loans** comprise sector adjustment loans (15.9% of lending), which aim to support policy reforms or institutional advances in a given sector, and structural adjustment loans

¹ Unless specified otherwise, the IBRD figures presented in this analysis are from the financial years ending on 30 June 2002, 30 June 2003, 30 June 2004, 30 June 2005 and 30 June 2006.

(15.8%), which aim to encourage specific macroeconomic policy reform. Policy-based loans made up 31.7% of AfDB's total loan portfolio at end-2006.

AfDB's Outstanding Portfolio by Product Type (2005–2006)

(UAm)	2006	2005
Public project loans	2,587.2	2,848.9
Policy-based loans	1,679.0	1,558.8
Private project loans	316.2	362.1
Agency lines	0.0	0.0
Others	708.5	742.6
Total lending	5,290.9	5,512.4
Equity investments ^a	59.6	74.8
Guarantees	8.1	0.0

^a Excluding investment in the ADF
Source: AfDB

Private-Sector Activities

Besides project loans, which are not exclusively directed at public-sector entities, the bank also offers other financial instruments to assist private entities, such as agency lines, equity stakes and guarantees.

- **Agency lines**, introduced in 2005, consist of loans to private-sector enterprises whose supervision is entrusted to a local financial institution. The latter must supervise the project's implementation as the credit risk of the borrower is solely borne by AfDB. There were no amounts outstanding under agency lines at end-2006.
- **Equity participations** include common shares and preferred stocks with or without participating features. The bank does not intend to assume management responsibility of an enterprise in which it invests and usually develops an exit strategy once the goals of the project are achieved. AfDB's by-laws authorise it to hold up to 25% of an enterprise's capital. At end-2006, equity stakes – excluding investment in the ADF – accounted for 1.1% of the bank's total gross lending and equity exposure.
- **Guarantees** generally act as a credit enhancement product whereby borrowers raise funds with third-party credit institutions using AfDB's preferred creditor status signature. The amount of guarantees outstanding was UA8.1m at end-2006.

Non-Lending Debt Initiatives

The bank mainly grants debt relief under the HIPC Initiative. A new debt alleviation programme – the

Post-Conflict Country Facility (PCCF) – was introduced in 2004, and the bank, through the ADF, is also involved in the MDRI.

- The HIPC Initiative was launched in 1996 by governments of the developed world and multilateral creditors to relieve the external debt burden of the poorest countries. As at end-December 2006, 33 of the bank's RMCs were eligible for assistance; at this stage 25 countries had fulfilled the conditions to qualify for debt relief (known as the "decision point"). Once approval is 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"): to date, 17 RMCs have reached the completion point compared with 14 in 2005. The cost of the HIPC initiative for the 33 potential HIPCs is estimated at USD3.6bn and the African Development Bank Group had mobilised USD2.4bn as at end-December 2006.
- A framework, the PCCF, was established in 2004 to enable countries facing civil war or post-conflict situations to clear their arrears and benefit from reconstruction efforts and debt reduction under HIPC. The PCCF is funded by donors and allocations from the ADF and AfDB's net income. Three countries (Congo, Burundi and the Central Republican Republic) have qualified for arrear clearance under this scheme². The Democratic Republic of Congo (DRC) also benefited from an exceptional debt restructuring package or "DRC fund" arranged in 2002, which allowed it to clean all its arrears to the bank.
- Under the MDRI, three multilateral institutions – the International Development Association, the International Monetary Fund and the ADF – have agreed to cancel 100% of their debt claims on HIPC post-completion-point countries. In April 2006, the boards of directors of the ADF and AfDB approved USD8.5bn for financing debt relief of 33 MDRI-eligible RMCs after completion point. Unlike the HIPC Initiative, the impact of the MDRI on the bank will be limited, as it is not liable for the ADF's financial obligations.

² The other countries facing civil war or post-conflict situations are the Central African Republic, Congo, Cote d'Ivoire, Somalia, Liberia and Sudan.

- Capital, Funding and Liquidity
- **Shareholder support includes ownership by highly rated non-African countries**
- **Very high capitalisation and liquidity**

Capital

The ownership of the bank is controlled by 53 African countries, which held some 60% of subscribed capital at end-2006. Nigeria ('BB-'/'B'), Egypt ('BB+'/'B'), South Africa ('BBB+'/'F2') and Algeria (NR) were AfDB's largest African shareholders, holding 22.5% of the bank's capital. The remaining shares were held by 24 non-regional member countries, most of which are highly rated OECD countries. At end-2006, the main non-regional members were the United States ('AAA'/'F1+'), Japan ('AA'/'F1+'), Germany (AAA/'F1+'), Canada ('AAA'/'F1+') and France (AAA/'F1+'), which together owned close to 24% of AfDB's subscribed capital. Member countries with credit ratings between 'AAA' to 'AA-' controlled 37.6% of AfDB's capital at end-2006. The weighted average credit rating of all shareholders was 'BBB', reflecting the significant portion of capital held by RMCs.

Regional and Global MDBs:
Shareholders' Credit Ratings
(FYE06)

Credit quality of support	AfDB	AsDB	IADB	IBRD
Share of AA – and above callable capital (%)	37.6	60.3	49.8	59.2
Weighted average rating of all shareholders	BBB	A+	BBB+	A+

Source: MDBs, Fitch calculations and methodology

Support: Support from shareholders is provided through a mechanism common to all MDBs, where paid-in capital only accounts for a fraction (10.6% at end-2006) of subscribed capital. Capital subscribed but not paid in, or callable capital, may be called upon in the event of the bank being unable to honour its debt and guaranteed obligations. Considering AfDB's dominant role in the economic development of Africa, Fitch believes support from member countries would be forthcoming if necessary.

Capitalisation: To compare the capital adequacy of MDBs, Fitch has developed its own capital adequacy measures and concentrates on the ratio of usable capital to required capital³. As at end-2006, AfDB's ratio of usable capital to required capital stood at

18.3x (2005: 14.4x), the highest level ever achieved for a Fitch-rated MDB. Capitalisation benefited from three distinct factors: a 4.0% decrease in loans outstanding combined with a 21.3% drop in non-associate equity participations and an improvement in the credit quality of some sovereign borrowers.

Funding

AfDB's operations are funded by equity or by borrowing on the capital markets. In 2006, the bank raised a total of UA731m (2005: UA544m) in the capital markets at an average cost of USD LIBOR minus 24.7bp. The bank's funding is predominantly long term as outstanding borrowings with maturity of one year or less accounted for 11.9% of the bank's total borrowing portfolio at end-2006. Though slightly on the rise in 2006, AfDB's average amount of debt has been stagnating in recent years, due notably to a regular decline in lending activities. Debt reached 34.7% of callable capital at end-2006, little changed from 33.1% at end-2005 and well below the 47.7% average for all four regional and global MDB peers at end of the fiscal year ending in 2006 (FYE06).

Liquidity

AfDB holds a large portfolio of liquid assets, which represents readily available resources to meet daily cash requirements, but also funds loan and guarantee commitments when access to financial markets is restricted. At end-2006, the liquid assets portfolio consisted of tradeable securities (56.7% of the portfolio) and securities held to maturity (43.3%) in addition to interbank deposits. They are invested in hard currencies, primarily US dollars, euro and pounds sterling. The bank's cash and treasury investments peaked at UA5.3bn in 2006, rising from an already high UA4.8bn in 2005. Besides conservative liquidity management rules, continuous improvements in the bank's liquidity position have been fuelled by loan prepayments, which have reached significant levels in recent years (see *Market Risk*). Overall, AfDB is a highly liquid financial institution whose liquid assets and marketable debt accounted for 50.6% of total assets at FYE06, against 27.0% for the AsDB, 24.4% for the IADB and 12.6% for the IBRD.

■ Risks

- **Sovereign credit risk profile facing adverse trends**
- **The bank is well within its self-imposed prudential objectives**

Credit Risk

Sovereign Lending: AfDB's loan portfolio carries significant sovereign credit risk, reflecting the generally low credit quality of African countries. At

³ For a complete description of the ratio, see Fitch's "Multilateral Development Banks: Rating Criteria and Industry Review", published on 15 June 2005

end-2006, only two of the 10 largest borrowers were rated investment grade: Tunisia ('BBB'/F2') and South Africa ('BBB+'/F2'). Overall, financing extended to speculative-grade counterparties accounted for 73.0% of the bank's loan portfolio at end-2006 (2005: 74.7%). Most risks lie in the loans granted to countries in conflict situations and in chronic arrears, such as the Côte d'Ivoire, Zimbabwe and Liberia.

Impaired loans have declined since 2002, with the combined effect of the HIPC Initiative and specific arrears clearance mechanism sponsored by the donor community (see *Non-Lending Debt Initiatives*). As a result, the bank's non-performing loans accounted for 12.7% of outstanding loans at end-2006, stable on 12.7% at end-2005 and improved on 19.9% at end-2004 but still considerably higher than for other MDBs. AfDB's sovereign portfolio is affected by two contradictory trends. In one respect, defaults since 2000 – from two large borrowers, Zimbabwe and Côte d'Ivoire – have delayed the general clean-up of AfDB's loan book. In another respect, some of the bank's member countries have recently experienced improvements in their credit fundamentals. When neutralising the effect of the accounting restatement on the recorded loan exposure to DRC in 2005 (see *Performance and Prospects*), the weighted average credit rating of AfDB's sovereign loan portfolio is brought to 'BB-' at end-2006, up from 'B' at end-2002. Among rated peers, only the weighted average credit rating of the IADB's loan portfolio presented a similar risk profile at 'B+', while those of the AsDB and the IBRD carried much less risk at 'BB+' at FYE06.

Private-Sector Lending: The private-sector window of the bank was established in 1991 and a new private-sector development strategy was approved in 2004. In line with the objective of broadening the scope of development assistance to RMCs, private-sector financing (lending and equity) increased gradually to 8.1% of AfDB's total outstanding portfolio at end-2006 from 2.2% at end-2001. There is a concern that the growing share of non-sovereign lending could lead to a deterioration in the bank's asset quality. However, the bank has set conservative prudential non-sovereign limits, notably drawn from its capital allocation framework (see *Risk Management*). For instance, as a part of AfDB's 2003-2007 strategic plan, a formal limit was approved for the capital allocated to non-sovereign operations at 20% of the bank's net paid-in capital, net reserves and loan loss provisions (referred to as "risk capital"). As at end-2006, the outstanding non-sovereign portfolio utilised only 3.5% of such risk capital. AfDB's internal 10-point risk rating scale reassures about the credit performance of private-

sector activities: the weighted average risk rating of the non-sovereign and equity portfolios has fallen from 4.7 in 2001 to 3.5 in 2006, gradually converging to that of the sovereign portfolio (2006: 2.9; higher values indicate higher risk).

Concentration Risk: As with other MDBs that lend to developing countries, AfDB's loan portfolio is marked by a very high level of concentration. At end-2006, the 10 largest exposures accounted for 83.8% of AfDB's entire loan portfolio, in line with the 82.4% average ratio for rated peers. This lack of granularity results principally from strict lending eligibility criteria, which the bank applies to potential borrowing countries: since 1995, AfDB's loans have been limited to 15 "eligible" countries,⁴ while other RMCs only have access to concessional financing from the ADF. Fitch notes, however, that concentration ratios have improved relative to the bank's equity: AfDB's combined exposure to its five largest borrowers was equivalent to 81.1% of shareholders' equity at end-2006 against 128.6% at end-2001. Such performance is in part explained by internal exposure guidelines, which limit any borrowing country's loan exposure to 15% of the bank's maximum sustainable portfolio – i.e. the sum of the outstanding portfolio plus the potential new lending derived from unused risk capital. Loans to Tunisia, AfDB's largest exposure at end-2006, represented 66% of this limit.

Loan Loss Experience and Reserves: in spite of continuing adverse political and economic developments in the region, AfDB has never had to write off a sovereign loan. Such achievement reflects a privileged treatment AfDB shares with other MDBs: preferred creditor status, which confers priority over other creditors in the event of a sovereign default. Preferred creditor status does not generally apply, however, to private-sector loans. Risk arising from private-sector diversification is nevertheless partly mitigated by the bank's stringent provisioning rules and its general treatment of overdue payments. Indeed, when principal or interest is more than 30 days overdue, the African Development Bank Group ceases disbursement as well as approvals of any new loans from all of its three operating entities (AfDB, ADF and NTF). Loans in arrears for more than six months (three when the loan is non-sovereign guaranteed) are classified as non-performing. Fitch notes that AfDB's coverage ratios are nevertheless less conservative than those of comparable peers. In particular, provisions covered only 65.2% of total

⁴ Algeria, Botswana, Egypt, Equatorial Guinea, Gabon, Libya, Mauritius, Morocco, Namibia, Nigeria, Seychelles, South Africa, Swaziland, Tunisia and Zimbabwe.

non-performing loans at FYE06 compared with 441.2% for the AsDB, 136.4% for the IADB and 221.2% for the IBRD.

Regional and Global MDBs' Coverage Ratios (FYE06)

	AfDB	AsDB	IADB	IBRD
NPL/loans (%)	12.7	0.1	0.1	1.0
Provisions/NPL (%)	65.2	441.2	136.4	221.2
Provisions/gross loans (%)	8.3	0.60	0.2	2.2

Source: MDBs, Fitch's methodology and calculations

Investment Portfolio: There is also residual credit risk relating to the bank's liquid assets portfolio clearly mitigated by conservative investment guidelines. The bank cannot invest in financial instruments rated below 'AA-'; the limit is 'A' for money market instruments. Asset-backed securities are restricted to 'AAA'-rated bonds. As at end-2006, 50.4% of the bank liquid asset exposure was with 'AAA'-rated counterparties, 41.6% with 'AA'-rated entities and the remainder with 'A' counterparties. In view of the quality of the securities held (averaging 'AA'), credit risk on this portfolio is not significant.

Equity Risk

In addition to its credit risk exposure and its rising non-sovereign-guaranteed lending, AfDB's equity stakes could also alter its risk profile. At end-2006, outstanding equity investments amounted to UA119.1m, of which UA63.0m related to the bank's participation in the ADF. The bank's charter limits equity investments to 10% of the aggregate amount of the bank's paid-up capital and reserves and surplus included in its ordinary capital resources. Equity stakes stood at 25.8% of this statutory limit at end-2006 (end-2005: 33.8%).

Equity investments are usually reported at fair value on the bank's balance sheet. When an investment in equity securities without readily determinable fair value is deemed non-performing, a provision measured against the bank's carrying cost is made. As at end-2006, the average provisioning rate for equity investments in the private sector stood at 6.24% of the outstanding equity portfolio (2005: 4.90%).

Market Risk

AfDB's exposure to market risk is minimal, as market activities are not viewed as a profit-maximising activity. The bank employs a strategy of currency and interest rate matching across the

balance sheet. A large share of AfDB'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. Currency mismatching is also kept to a minimum: loans are denominated in convertible currencies (USD, EUR, GBP, CHF and 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 recent years, a number of borrowers prepaid their loans, in particular the fixed-rate loans issued before 1997, which carry a high interest rate and do not charge any prepayment penalty. However, prepayments are stabilising, amounting to UA298m in 2006 (5.6% of outstanding loans) and UA262m in 2005 (4.8% of outstanding loans), down from a peak UA542m in 2004 (10.4% of outstanding loans).

Risk Management

Like other MDBs, AfDB is not subject to international banking regulations and abides by self-imposed liquidity, capital and gearing policies. Overall, the bank is well within its internal prudential objectives, which provide some headroom for future operational developments.

Liquidity: Liquidity management rules 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. As at end-2006, total liquid assets accounted for about 2.2 times of such prudential level of liquidity.

Capital: AfDB's by-laws limit the total amount of both undisbursed and outstanding loans, equity stakes and guarantees to 100% of subscribed capital, reserves and net income. At end-2006, this ratio was 32.4%. From an operational standpoint, the risk-sensitiveness of AfDB's portfolios of assets is also systematically assessed in relation to the bank's effective risk bearing capacity or "risk capital". For instance, the bank's sovereign portfolio utilised 41% of risk capital at end-2006 and overall, 53% of the bank's risk capital was left unused.

Gearing: The board of directors has set the ceiling on borrowing at 80% of callable capital: at end-2006, total debt accounted for 30.2% of the bank's callable capital (2005: 30.7%). Limits have also been set for senior debt, which is capped at 80% of callable capital held by non-borrowing countries (this ratio reached 60.7% as at end-2006).

■ Performance and Prospects

- **No impact on the bank's credit fundamentals from new accounting treatment of income transfers**
- **Declining trend in lending has mixed effect on the bank's risk profile**

The bank's financial statements are presented under International Financial Reporting Standards (IFRS). Applicable since 2005, one revised rule – IAS 32 – has had an adverse effect on the bank's financial statements. It led to the qualification of AfDB's accounts by auditors, on the ground that, according to IFRS, capital subscriptions from member countries cannot be accounted for as equity but as a liability, as member countries are allowed to withdraw from the bank at any time. In Fitch's view, the qualification is a matter of accounting interpretation and has no relation with the bank's intrinsic financial strength. In addition, it has to be mentioned that the statutes of AfDB and its treatment of member countries' capital subscription are consistent with the MDBs' industry practice.

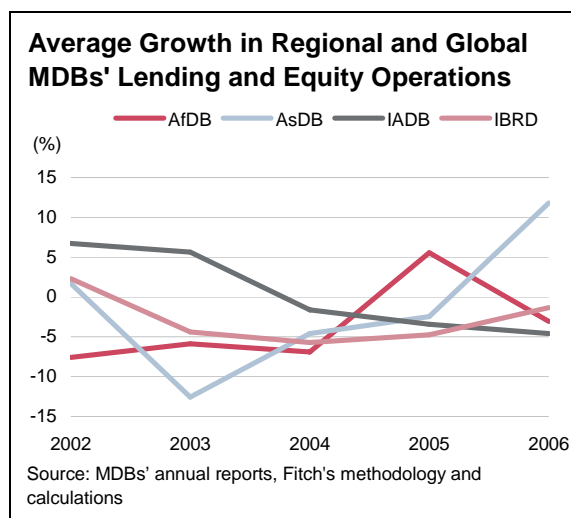
Performance

Though AfDB does not distribute dividends, a significant portion of net income is allocated to debt reduction and arrears clearance schemes in which both AfDB and the ADF participate. These allocations amounted to UA139m, or 71.7% of the 2006 operating profit. The bank's management changed the accounting treatment for transfers approved by its board of governors in 2006. Previously reported as a distribution from retained earnings, these allocations are now reported as expenses in the income statement. While this has led to a significant reduction in AfDB's published net income (-71.7% in 2006 and -65.1% in 2005), Fitch does not regard the induced reduction of earnings as an adverse credit event, particularly as profitability is not a key rating factor for MDBs.

Overall, the profitability of AfDB has been stable in recent years though the aforementioned restatement has led to weaker performances than those of other MDBs. The main drivers of AfDB's earning generation are changes in loan loss provisions and, to a smaller extent, interest rates: the decline in profits in 2006 was mainly explained by the increase in provisions (a charge of UA51.7m in 2006 compared with a write-back of UA13.8m in 2005); it is also attributable to the rise in interest rates on USD, which led to a 37.6% increase in revenues from treasury investments but was largely offset by a corresponding increase in financial charges.

Trends and Prospects

The application of IAS 39 accounting rule in 2005 led to a one-time recognition of UA720m of previously non-accrued interest, including a component of the DRC loan, which was re-incorporated both in the bank's equity and assets. This artificially increased AfDB's portfolio by 5.6% in 2005. However, AfDB's portfolio shrank by 3.1% yoy in 2006, continuing a trend that started in the late 1990s as some RMCs gained easier access to capital markets thanks to improved credit fundamentals.



From a pure credit perspective, such developments are at first sight fairly positive. In fact, prepayments, an underlying driver of a lower volume of outstanding loans, originate from customers with the best credit, clearly mitigating the impact of rating upgrades on the portfolio's credit quality. Meanwhile, arrears to other countries, such as Zimbabwe and Côte d'Ivoire, continue to build up. The performance of AfDB's loan book reflects such trends and though the number of sovereign borrowers in arrears decreased from eight at end-2005 to six at end-2006, total loan provisions rose by 11.3% as prospects of recovery on some sovereign loans – Zimbabwe, for instance – have become gloomier.

In the medium term, the share of non-performing assets could also be boosted by AfDB's growing emphasis on non-sovereign activities, its principal response to the decline in demand for public-sector loans. Private-sector lending approvals accounted for 29.1% of lending approvals in 2006, against 18.5% in 2005 and 20.0% in 2004. It is Fitch's view that, at current operational trends, AfDB's conservative prudential framework constitutes solid safeguards to cope with the risks arising from the ongoing shift in lending.

Balance Sheet Analysis
AFRICAN DEVELOPMENT BANK

	31 Dec 2006				31 Dec 2005		31 Dec 2004	
	Year End USDm	Year End XDRm	As % of Assets	Average XDRm	Year End XDRm	As % of Assets	Year End XDRm	As % of Assets
	Original	Original	Original	Original	Original	Original	Original	Original
A. LOANS								
1. Loans made through Banks	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-
2. To/Guaranteed by Public Institutions	7,480.9	4,974.8	40.41	5,062.6	5,150.3	44.50	5,321.5	49.45
3. To Private Sector	475.5	316.2	2.57	339.2	362.1	3.13	319.0	2.96
4. Trade Financing Loans	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-
5. Other Loans	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-
6. Loan Loss Reserves (deducted)	656.8	436.8	3.55	414.6	392.4	3.39	401.7	3.73
TOTAL A	7,299.5	4,854.2	39.43	4,987.1	5,120.0	44.23	5,238.8	48.68
B. OTHER EARNING ASSETS								
1. Deposits with Banks	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-
2. Securities held for Sale & Trading	5,196.5	3,455.7	28.07	3,206.8	2,957.9	25.55	2,302.9	21.40
3. Investment Debt Securities - (incl. other invest.)	3,972.2	2,641.5	21.46	2,421.3	2,201.0	19.02	2,136.4	19.85
4. Equity Investments	179.1	119.1	0.97	143.9	168.7	1.46	160.6	1.49
5. Derivatives (incl. Fair-value of guarantees)	411.0	273.3	2.22	279.6	285.9	2.47	274.8	2.55
TOTAL B	9,758.8	6,489.6	52.71	6,051.6	5,613.5	48.50	4,874.7	45.30
C. TOTAL EARNING ASSETS (A+B)	17,058.3	11,343.8	92.14	11,038.7	10,733.5	92.73	10,113.5	93.98
D. FIXED ASSETS	21.5	14.3	0.12	15.4	16.4	0.14	17.6	0.16
E. NON-EARNING ASSETS								
1. Cash and Due from Banks	194.4	129.3	1.05	99.8	70.3	0.61	43.8	0.41
2. Other	1,239.4	824.2	6.69	789.5	754.8	6.52	586.1	5.45
F. TOTAL ASSETS	18,513.7	12,311.6	100.00	11,943.3	11,575.0	100.00	10,761.0	100.00
G. SHORT-TERM FUNDING								
1. Bank Borrowings (< 1 Year)	1,320.0	877.8	7.13	672.4	467.0	4.03	9.3	0.09
2. Securities Issued (< 1 Year)	1,049.6	698.0	5.67	699.2	700.4	6.05	606.1	5.63
3. Other (incl. Deposits)	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-
TOTAL G	2,369.6	1,575.8	12.80	1,371.6	1,167.4	10.09	615.4	5.72
H. OTHER FUNDING								
1. Bank Borrowings (> 1 Year)	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-
2. Other Borrowings (incl. Securities Issues)	6,737.9	4,480.7	36.39	4,495.5	4,510.3	38.97	5,032.8	46.77
3. Subordinated Debt	1,040.2	691.7	5.62	710.7	729.7	6.30	n.a.	-
4. Hybrid Capital	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-
TOTAL H	7,778.0	5,172.4	42.01	5,206.2	5,240.0	45.27	5,032.8	46.77
I. OTHER (Non-Int Bearing)								
1. Derivatives (incl. Fair value of guarantees)	724.7	481.9	3.91	399.5	317.2	2.74	513.9	4.78
2. Fair value portion of debt	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-
3. Other (Non-Int Bearing)	975.8	648.9	5.27	573.6	498.2	4.30	377.2	3.51
J. GENERAL PROVISIONS & RESERVES	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-
L. EQUITY								
1. Preference Shares	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-
2. Subscribed Capital	32,695.8	21,742.7	176.60	21,689.4	21,636.0	186.92	21,597.9	200.71
3. Callable Capital	-29,228.1	-19,436.7	-157.87	-19,401.9	-19,367.0	-167.32	-19,374.6	-180.04
4. Arrears/Advances on Capital	-269.2	-179.0	-1.45	-181.1	-183.2	-1.58	-188.2	-1.75
5. Paid in Capital (memo)	3,467.5	2,305.9	18.73	2,287.5	2,269.1	19.60	2,223.3	20.66
6. Reserves (incl. Net Income for the year)	3,466.9	2,305.5	18.73	2,515.6	2,725.7	23.55	2,652.1	24.65
7. Fair-value revaluation reserve	0.2	0.1	0.00	-229.6	-459.3	-3.97	-465.5	-4.33
TOTAL L	6,665.6	4,432.6	36.00	4,392.4	4,352.2	37.60	4,221.7	39.23
M. TOTAL LIABILITIES & EQUITY	18,513.7	12,311.6	100.00	11,943.3	11,575.0	100.00	10,761.0	100.00
Exchange Rate		USD1 = XDR 0.6650			USD1 = XDR 0.6997		USD1 = XDR 0.6439	

Income Statement Analysis
AFRICAN DEVELOPMENT BANK

	31 Dec 2006		31 Dec 2005		31 Dec 2004	
	Income	As % of	Income	As % of	Income	As % of
	Expenses	Total AV	Expenses	Total AV	Expenses	Total AV
	XDRm	Earning Assts	XDRm	Earning Assts	XDRm	Earning Assts
	Original	Original	Original	Original	Original	Original
1. Interest Received	537.3	4.87	472.3	4.53	436.8	-
2. Interest Paid	277.6	2.51	219.8	2.11	195.5	-
3. NET INTEREST REVENUE	259.7	2.35	252.5	2.42	241.3	-
4. Other Operating Income	2.6	0.02	10.0	0.10	8.3	-
5. Other Income	146.9	1.33	130.6	1.25	111.1	-
6. Personnel Expenses	123.2	1.12	124.5	1.19	116.1	-
7. Other Non-Interest Expenses	37.3	0.34	38.3	0.37	32.5	-
8. Impairment charge	51.7	0.47	-13.8	-0.13	53.9	-
9. Other Provisions	34.7	0.31	-0.8	-0.01	-3.3	-
10. PRE-DERIVATIVE OPERATING PROFIT	162.3	1.47	244.9	2.35	161.5	-
11. Net gains / (losses) on non-trading derivative instruments	31.7	0.29	-23.6	-0.23	-18.0	-
12. POST-DERIVATIVE OPERATING PROFIT	194.0	1.76	221.3	2.12	143.5	-
13. Other income and expenses	-139.2	-1.26	-144.0	-1.38	n.a.	-
14. NET INCOME	54.8	0.50	77.3	0.74	143.5	-
15. Fair value revaluations recognised in equity	459.4	4.16	6.2	0.06	n.a.	-
16. FITCH'S COMPREHENSIVE NET INCOME	514.2	4.66	83.5	0.80	143.5	-

Ratio Analysis

AFRICAN DEVELOPMENT BANK

		31 Dec 2006 Original	31 Dec 2005 Original	31 Dec 2004 Original
I. PROFITABILITY LEVEL				
1. Net Income/Equity (av.)	%	1.25	1.80	n.a.
2. Net Income/Total Assets (av.)	%	0.46	0.69	n.a.
3. Net Interest Revenue + Commitment				
Fees/Gross Loans (av.) + Liquid Assets (av.) + Average Guarantees (av.)	%	2.37	2.47	n.a.
4. Non-int. Exp./Net Interest Rev. + Other Operating Income				
5. Income from Equity Investment/Equity Investment (av.)	%	61.19	62.02	59.54
6. Provision on Loans & Equity Part. & Guarantees/				
Gross Loans (av.) + Equity Investment (av.) & Guarantees (av.)	%	1.56	-0.25	n.a.
II. CAPITAL ADEQUACY				
1. Internal Capital Generation	%	1.25	1.80	n.a.
2. Outstanding Loans + Net Equity Invest. + Net Guarantees				
/Subscribed Capital + Reserves	%	20.71	21.71	22.39
3. Equity/Total Assets	%	36.00	37.60	39.23
4. Equity ex. fair-value revaluations/Assets	%	36.00	41.57	43.56
5. AAA-AA- Callable Capital/Callable Capital	%	37.55	37.64	37.66
7. Usable Capital/Required Capital	%	1,832.88	1,443.98	1,590.31
III. LIQUIDITY				
1. Liquid Assets & Marketable Debt				
Securities/Debt < 1 Year	%	395.13	447.94	728.49
2. Liquid Assets & Marketable Debt				
Securities/Total Assets	%	50.57	45.18	41.66
3. Liquid Assets + Marketable Debt				
Securities/Undisbursed Loans and Equity	%	306.71	281.59	294.09
IV. ASSET QUALITY				
1. Impaired Loans /Gross Loans	%	12.66	12.74	19.88
2. Loan Loss Reserves / Gross Loans	%	8.26	7.12	7.12
3. Equity Loss Reserves /Equity Investment	%	2.85	2.03	2.55
4. Total reserves / Gross Loans, Equity Investment & Guarantees	%	8.10	7.00	7.00
5. Loan Loss Reserves/Non Accrual Loans	%	65.18	55.86	35.82
6. Loans to Investment Grade Borrowers/Gross Loans				
Loans	%	26.96	25.31	26.78
V. LEVERAGE				
1. Debt/Equity	%	152.24	147.22	133.79
2. Debt/Subscribed Capital + Reserves	%	28.06	26.30	23.29
3. Debt/Callable Capital	%	34.72	33.08	29.15
4. Net Income + Interest Paid/Interest Paid	%	119.74	135.17	173.40

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