

# African Development Bank

Supranational

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## Analyst Contacts:

DUBAI	+971.4.237.9536
Aurelien Mali	+971.4.237.9537
<i>Vice President - Senior Analyst</i>	
aurelien.mali@moodys.com	
LONDON	+44.20.7772.5454
Kilbinder Dosanjh	+44.20.7772.1376
<i>Vice President - Senior Analyst</i>	
kilbinder.dosanjh@moodys.com	
Yves Lemay	+44.20.7772.5512
<i>Managing Director - Banking</i>	
yves.lemay@moodys.com	

» contacts continued on the last page

This Credit Analysis provides an in-depth discussion of credit rating(s) for African Development Bank and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on [Moody's website](#).

## Summary Rating Rationale

We rate the African Development Bank (AfDB) Aaa/Prime-1, with a stable outlook. The Bank's ratings reflect a combination of its intrinsic financial strength, prudent financial management and policies and very strong shareholder support. These strengths offset the fairly low average credit quality of AfDB's loan portfolio, a result of the Bank's challenging regional operating environment.

According to the AfDB's own rating scale, the weighted-average quality of its development-related assets is lower than those of most of its Aaa-rated peer multilateral development banks (MDBs). The AfDB's percentage of nonperforming loans (NPLs) – 2.8% at the end of 2012 – is still high for an MDB, mainly related to arrears from countries no longer eligible to borrow from the AfDB, including Somalia, Sudan and Zimbabwe. However, in recent years, the AfDB's arrears-clearance mechanisms and the Heavily Indebted Poor Countries (HIPC) debt-relief programme have helped to substantially reduce the level of outstanding arrears. At the end of 2012, 29 out of 33 regional member countries eligible for debt cancellation had reached their completion point. The bank had to date already provided \$3.5 billion out of \$6 billion committed.

Since 2008, the AfDB has been deploying its balance sheet more extensively, substantially increasing its lending to both sovereign and private-sector counterparties. This results partly from a strategy of more actively supporting private-sector projects across Africa. However, the recent expansion was also the result of the AfDB's response to the global economic and financial crisis, developing new instruments to provide emergency liquidity and countercyclical measures.

Although these policies have increased the riskiness of the bank's loan portfolio, the changes do not threaten its ability to service its own debt. The volatile political situation in North Africa, where the bank's portfolio is heavily concentrated at around 45%, will require close monitoring while these countries experience difficult political transitions. However, the AfDB's robust capitalisation, ample liquidity buffers and sound risk-management framework help to offset the existing risks that the AfDB carries on its balance sheet and creates substantial headroom in risk-bearing capacity to further expand its lending.

Crucially, the AfDB's own resources are reinforced by its shareholder support, particularly in highly rated, non-regional governments. Shareholder support takes the form of callable capital, but can also materialise in the form of general capital increases. Since its creation in 1964, the AfDB has experienced six general capital increases, which illustrates the degree of shareholder commitment. The most recent General Capital Increase (GCI-VI), approved in May 2010 by shareholders, included a record-high 200% capital increase that tripled the AfDB's authorised capital base to around \$100 billion. The capital increases allow the AfDB to fully implement its expansion strategy, even under the most severe scenarios, without overstressing its risk-bearing capacity beyond a level consistent with a Aaa rating. The role assumed by the AfDB during the crisis highlighted in particular the value it represents to all its members. The AfDB acts primarily as a financing vehicle that supports its shareholders' development objectives in Africa.

### Organisational Structure and Mandate

The AfDB is a multilateral financial institution created in 1964. Its statutory objective is to promote sustainable economic growth and reduce poverty in Africa. The bank is formally located in Abidjan, Côte d'Ivoire, but following political instability it has operated from its Temporary Relocation Agency site in Tunisia since 2003. After 10 years, the relocation to Abidjan is scheduled to happen in waves until the end of 2014. The AfDB also has more than 30 operating field offices, with two serving as regional offices (Regional Resource Centres in South Africa and Kenya) and plans to open more. The largest office in South Africa can host around 900 staff and is *de facto* a third emergency relocation for the headquarters if needed.

The AfDB is part of the African Development Bank Group, which also includes the African Development Fund (established in 1972) and the Nigeria Trust Fund (established in 1976). The three entities of the Group complement each other as follows:

- » The AfDB is the non-concessional window of the Group. It finances projects through loans (to sovereign or private-sector counterparties), guarantees and equity investments. It also provides technical assistance. The AfDB currently can extend loans to only 16<sup>1</sup> of the 54 sovereign governments of Africa, but can extend loans to private-sector counterparties across the continent. As a result, it had effective exposure to 32 countries at the end of 2012.
- » The African Development Fund is the concessional window of the Group. It finances projects in low-income African countries in the form of concessional loans and grants. Countries eligible for sovereign loans from the Fund are not normally eligible to borrow from the AfDB.<sup>2</sup> The Fund's resources come from periodic contributions by donor governments (all bar South Africa, Egypt and Botswana being non-African).
- » The Nigeria Trust Fund is a comparatively small fund that extends grants and loans at concessional rates and is funded by contributions from the Government of Nigeria.

**Moody's ratings apply solely to the AfDB and not to other entities of the Group.**

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

<sup>2</sup> With the exception of Nigeria eligible to borrow from both windows.

The membership structure of the AfDB, which initially included only African governments, was opened up in 1982 to allow non-regional governments to participate. These newer members contribute to the AfDB's capital, but are not eligible to borrow from it. The AfDB currently has 77 shareholders, 53 of which are African governments, while the other 24 are mostly highly rated governments from the OECD and the Middle East.<sup>3</sup> This number is expected to rise to 81, as Turkey, Luxembourg and Australia are in the process of becoming non regional shareholders and South Sudan a regional member.<sup>4</sup> African members account for 60% of the AfDB's capital and non-regional shareholders for the remaining 40%.

The balance of participation between regional and non-regional countries is reflected in its governance structure. The AfDB's highest decision-making body is the Board of Governors, which includes one representative per member country. Decisions by the Board of Governors require a two-third majority (or 70% on key issues, should any member require so). As each member's number of votes is based on the share of that member in the capital stock of the bank, the voting rule ensures that any significant decisions require support by both regional and non-regional members.

The Board of Governors elects a Board of Directors, which is responsible for overseeing the AfDB's operations. The Board of Directors comprises 13 representatives elected by regional countries, and 7 representatives elected by non-regional countries. Decisions in the Board of Directors equally require a two-third majority (or 70% on key issues if expressly required by a member) of votes, weighed by the share of capital of the members represented by each Director.

The AfDB's Board of Directors has been chaired since September 2005 by Donald Kaberuka, formerly minister of finance and economic planning in Rwanda. He was re-elected for a second term in May 2010 and on 1 September 2010 was sworn in for another five years.

#### **Africa50Fund to address Africa's infrastructure gap**

The Africa50Fund is the latest initiative by the AfDB to finance the continent's infrastructure projects and address the growing infrastructure deficit. While the fund will be a legally and financially separate entity with its own capital structure, the fund will draw on the AfDB's operational experience and presence on the continent. It will initially be financed through equity, but we expect that it will issue debt after establishing a track record of operations. Equity providers are expected to be primarily African governments, the AfDB (within its existing framework for equity investments and subject to Board approval), pension funds and sovereign wealth funds.

The primary purpose of the Africa50Fund is to help scale up the financing of infrastructure projects in Africa, focusing on both project development and project finance. To this end, the fund will utilise programmes such as the Programme for Infrastructure Development in Africa (PIDA) Priority Action Plan and the Presidential Infrastructure Champions Initiative (PICl). Overall, the Africa50Fund will aim at reducing the timeline from project idea to financial close from a current average of 7 years to an intended 3 years, thus accelerating the pace of infrastructure delivery in the continent.

<sup>3</sup> Argentina, Austria, Belgium, Brazil, Canada, China, Denmark, Finland, France, Germany, India, Italy, Japan, Korea, Kuwait, the Netherlands, Norway, Portugal, Saudi Arabia, South Korea, Spain, Sweden, Switzerland, the United Kingdom and the United States.

<sup>4</sup> Payments for South Sudan, Luxembourg and Australia are expected within the next years.

## Strategy and Objectives

The AfDB is set to continue to expand its operations across the continent, despite a challenging political and economic environment. The latter has been aggravated by both socio-political events in North-Africa (in the aftermath of the Arab Spring) and the negative effects of the ongoing global crisis. As a result of these risks, the AfDB launched a strategic review of its risk management framework in order to better assess, monitor and prevent operational and financial risks and has significantly strengthened its capital base, mainly through the record 200% capital increase approved in 2010 that tripled the AfDB's capital base to around \$100 billion.

Subsequent to the GCI-VI, the AfDB's own resources will steadily increase until 2020, at a pace of SDR305 million (equal to about \$470 million) corresponding to yearly paid-in instalments due from its shareholders and a further SDR150 million (around \$230 million) self-generated corresponding to a portion of net income allocated to reserves. It is therefore our conservative assumption that the bank's own resources will increase by close to SDR0.5 billion every year until 2020. Those resources will not only allow the bank to continue to increase the size of its loan portfolios without breaching any prudential limits of its own risk-management framework but it should also, if needed, allow the bank to absorb more risk on its balance sheet. In particular, it will to a great extent shield the bank against both the consequences of acute volatility on the international financial markets as well as the situation in North-Africa.

The AfDB's medium-term strategy foresees annual project approvals of approximately SDR3.6 billion over the next decade, including crisis-related lending. The Bank's strategy of committing more resources towards loans and equity investment for private-sector projects has not been modified to accommodate member states' financing needs during the recent global crisis. Over the next few years, the AfDB foresees around 60% of the anticipated SDR3.6 billion yearly approvals directed to sovereigns and 40% to the private sector.

AfDB's priorities developed in its medium-term strategy have remained consistent. The bank will continue to promote (1) key infrastructure projects, (2) regional integration, (3) private sector development and (4) stronger governance, skills and technology across the continent. To better fulfil its mandate, the bank is continuing with decentralisation, with field presence in 34 countries. We expect that the decentralisation strategy, while driven by the need to be closer to the member countries served by the Bank, will have the added benefit of making the bank more resilient to possible business continuity events, especially noting recent events in Côte d'Ivoire and Tunisia. Building on this medium term strategy, the bank approved a 10 year strategy that spanned over 2013-22 with two main goals over that period of (1) helping Africa to both achieve a more inclusive growth; and (2) to gradually transition to a "greener growth" (i.e., more sustainable and protecting livelihoods as well as water, energy and food security).

## Financial Strength

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### Governance and Risk Management

As a supranational entity the AfDB is not regulated and has therefore developed its own risk management framework, operating under a self-imposed conservative capital adequacy framework, liquidity policy and capital ratios (see Liquidity and Funding). The AfDB follows sound and conservative principles in the management of its asset/liability position, in line with its MDB peers. The bank's approach to risk management is underpinned by the principle that its risk-bearing capacity should be geared towards supporting its development-related operations, which implies that the other

financial risks it faces should be minimised (such as market, counterparty and operational risk). Counterparty risk in the bank's treasury operations is mitigated by counterparty selection and by the collateralisation of exposures arising from derivative contracts. Currency risk is mitigated by AfDB's policy of matching the currency composition of its lending and borrowing, and of matching the currency composition of its net assets to that of the Special Drawing Right (SDR). The AfDB also requires borrowers to service their loans in the currencies in which they are disbursed. Interest-rate risk is mitigated by matching the interest-rate characteristics of each class of assets with those of the corresponding liabilities. Liquid assets are invested conservatively (see asset composition and quality section for details) to provide cover for more than twice short-term debt at the end of 2012 (defined as debt redemption and debt callable within less than one year).

We note that because of the high-risk environment in which it operates, the AfDB, perhaps more than any other MDB, constantly tries to reform and improve its risk management as well as operational efficiency. In 2011, the bank completely revised its capital adequacy framework to better reflect its strategy. AfDB developed a more granular 22 grade scale to internally assess credit risk. It also revised the sovereign and non-sovereign probability of default rates and increased exposure limits toward the private sector. In addition as part of GCI commitment, the AfDB embarked on a wider reform agenda which included human resources, IT management and operations, business processes and policies. These reforms aim to improve co-ordination, delivery and corporate performance. All these changes are implemented to reflect the growing complexity resulting from the bank's strategy of fostering private sector lending throughout Africa. The AfDB has started the process to acquire a formal Operational Risk Management System (ORM), which by gathering daily data on risk management operational activities will allow a better assessment, monitoring, control and mitigation of risk.

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## Liquidity and Funding

### Liquidity

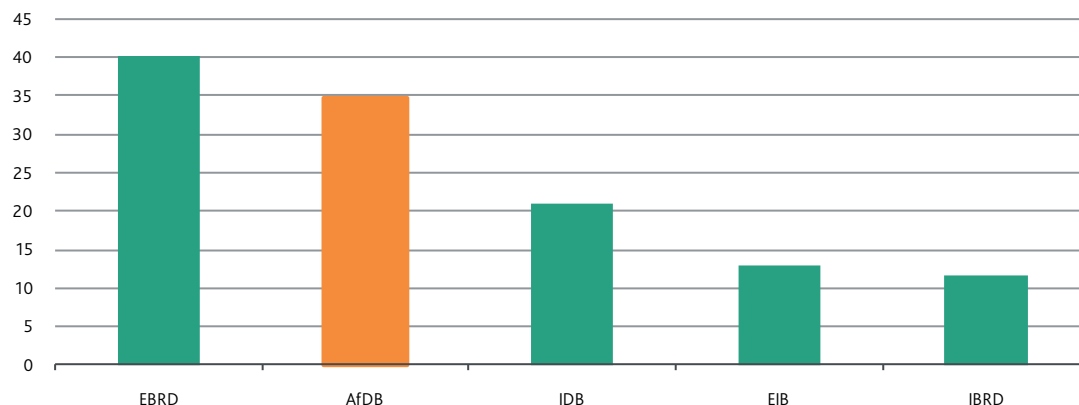
We attach particular importance to liquidity when assessing MDBs, as these institutions (with the exception of the European Investment Bank) are not eligible for the emergency liquidity facilities that central banks offer commercial banks. In a hypothetical scenario where its access to the market would be entirely shut down, the AfDB could only rely on its own liquid resources to meet its obligations, at least until contractual shareholder support materialised<sup>5</sup> (i.e., until callable capital is called and paid in).

The bank operates under a self-imposed liquidity policy, the objective of which is to ensure that it can meet all projected cash-flow needs for a rolling one-year period, without capital market financing. To do so, the AfDB maintains two types of treasury assets, which consist of two broad categories: trading assets and investments held at amortised cost. In early 2010, the AfDB revised the definition of eligible liquidity to include a larger portion of highly liquid assets in the amortised cost portfolio and to exclude non-liquid investments from the trading portfolio. The policy's projected cash-flow requirements include debt-service payments, net loan disbursements (disbursements minus repayments), the notional value of committed guarantees and the value of undisbursed equity investments. At the end of 2012, the AfDB's liquid portfolios totalled SDR7.4 billion, equivalent to 1.04x the prudential minimum required under its policy. Although the AfDB's ratio of available liquidity to required liquidity has fluctuated, it has remained consistently above 1x. At the end of 2012, cash and deposits generally used to finance the bank's short-term needs accounted for 31.1% of the trading portfolio and amounted to SDR1.4 billion. The AfDB's exceptionally robust liquidity position has allowed it to respond to the demands of its clients without overstretching its own liquid resources. Exhibit 1 below compares the large liquidity buffer of the AfDB with some Aaa-rated MDB peers.

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<sup>5</sup> The procedures involved in releasing the capital called by any multilateral development bank may take up to several months to fulfill. In the US, for example, Congressional approval is required before most of the payment of called capital may take place.

EXHIBIT 1

**Liquid Assets (Cash + Investments) as a % of Total Assets (as of December 2012)**

Source: AfDB, EBRD, IDB, IBRD, EIB, Moody's

### Funding

The likelihood of the AfDB not being able to access the markets is extremely remote, mainly because of its conservative risk-management policy. This was evidenced in the autumn and winter of 2008, when the AfDB and other multilateral institutions maintained their unimpaired access to capital markets, unlike many of their commercial counterparts.

The AfDB funds itself through opportunistic issuance in the capital markets. The execution of the borrowing program is influenced by market conditions and the pace of disbursements as it directly affects the bank's immediate cash flow needs and liquidity level. The bank accesses various markets, including African capital markets to support their development and uses a variety of instruments to meet its funding objectives. Although the AfDB's funding programme was set at SDR3.5 billion in 2012, it only borrowed SDR2.5 billion (or 73% of the program) with a weighted average maturity of 5.95 years. The overall maturity of the outstanding debt was 4.7 years at the end of July 2013. The 2013 borrowing program approved by the board was SDR3.76 billion, 64% of which was already financed at the end of July.

We do not expect that the AfDB will face any impediments to the execution of its issuance programme. In fact, the Bank has benefited from investor "flight to quality" since the beginning of this crisis as its cost of finance has been very favourable. Since 2009, the bank successfully issued global transactions with the aim of providing investors with at least one liquid reference bond every year and consequently to extend the US dollar yield curve. The bank issued two 5-year \$1 billion bonds in 2011 in February and August and one again in January 2012, as well as in January 2013. On average, two-thirds of these four transactions, were bought by central banks around the world. The most recent issuance was issued at only 20.45 basis points above US Treasury bills and re-opened at 12.1 basis points over US Treasury bills. The Australian dollar was the second currency for funding in 2012. In addition to issuances in South African rand (ZAR), we also note the multi-pronged approach to developing African capital markets, with issuances in Ugandan shillings (UGX) in 2012. We expect issuance programmes in Nigerian naira NGN and Zambian kwacha (ZMW) before the end of 2013.

## Capital Adequacy and Asset Composition and Quality

We assess the AfDB's capital adequacy based on very strong contractual member support, robust profitability levels and a strong level of risk-weighted capital adequacy despite a challenging operating environment.

### Contractual Support

In common with most MDBs, the AfDB has a share of its capital that is callable; an unconditional and full-faith obligation of each member country to provide additional capital for the sole purpose of servicing debt, the fulfilment of which is independent of the action of other shareholders. This characteristic, unique to MDBs, is a powerful line of protection to creditors, especially when some of the shareholders are rated Aaa or Aa. The AfDB's contractual support is very strong since Aaa-rated member countries accounted for 21.8% its capital structure, whilst Aa-rated members accounted for 13.6% at the end of July 2013, taking into account the downgrade to Aa1 from Aaa of France and the United Kingdom in November 2012 and February 2013, respectively.

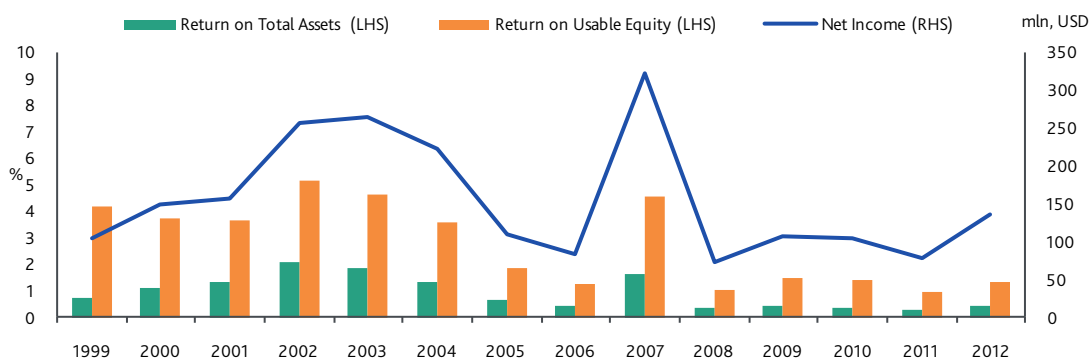
### Profitability

In 2012, the AfDB generated income before distribution of SDR199 million, higher than the SDR164 million recorded in 2011. The AfDB does not distribute dividends to shareholders in line with most MDBs, and its profits are allocated either to the reserves or to fund various development initiatives. The latter is a form of social dividend, but is reported as an expense in the Bank's income statement. After income distributions approved by the Board of Governors, the AfDB's net income was SDR89 million in 2012, higher than the SDR51 million recorded in 2011.

Over the years, this high level of profit distribution has slowed the growth of the Bank's capital base, which is credit negative. However, we note that the AfDB's increased distribution of income is in response to its members' demands to further their development objectives. This policy strengthens the support from which the bank benefits from its shareholders, which we ultimately hold as more critical to the bank's rating than profitability. However, in the coming years, it is likely that the bank will want to increase the share of income directed towards its reserves given its ambitious lending objectives. To achieve this goal, the bank modified its income model in 2011 to both improve internal-reserve generation and mitigate risk to income. The bank defined a minimum amount to allocate to reserves especially when and if its development related exposure (DRE)<sup>6</sup> faces increasing risks.

EXHIBIT 2

### Measures of Profitability 1999-2012



Source: AfDB and Moody's

<sup>6</sup> Includes net loans, guarantees, investments in regional member country bonds and equity participation.

In addition, the bank's net interest margin (NIM) strategy has been so far successful in limiting the impact of sharp interest-rate fluctuations on its net interest margin. Overall NIM rebounded from a low at 1.63% in 2011 to 1.87% in 2012, which was more in line with 2009 and 2010 results. Despite the low interest-rate environment, we do not expect that the effect on profitability will be substantial. Any volatility has less of an effect on revenue from development loans (whose interest rates are linked to the AfDB's borrowing costs), and similarly on the revenue of treasury assets funded by debt. Both portfolios target the same benchmark. Assets financed by the bank's equity remain the main income generator since the NIM on those assets averaged 4.6% between 2010-12 against 0.8% for debt-funded assets over the same period.

The AfDB, like most other MDBs, is not a profit-maximising institution. As a consequence, its financial strength relies less on its ability to generate earnings over time and more on the capital endowment provided by shareholders. Therefore, we do not expect that the bank's lower profitability would meaningfully endanger its rating. Net income is estimated to steadily increase (alongside the bank's total assets) to SDR350 million under conservative assumptions by 2020 as the balance sheet of the bank will have substantially expanded.

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### Capital Adequacy

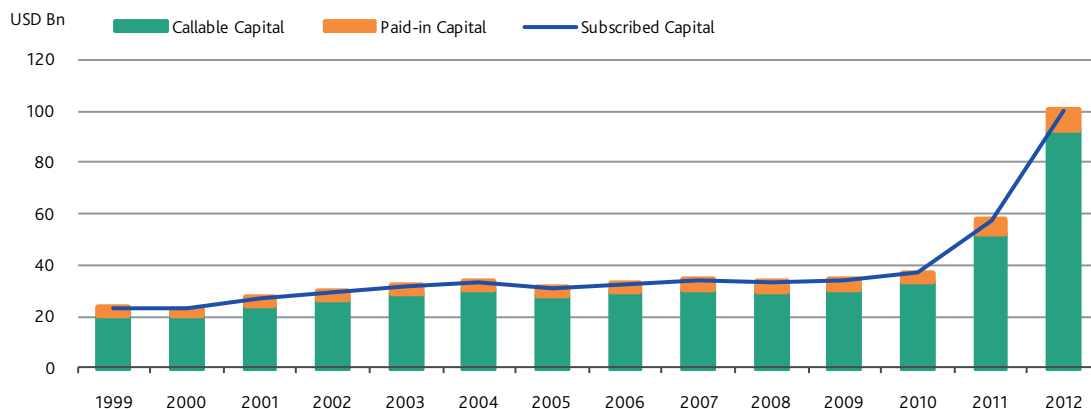
Capital adequacy features strongly in our assessment of MDBs' credit quality. AfDB's solid capitalisation is a key factor underpinning its Aaa rating, especially in view of the relative riskiness of its loan portfolio.

The AfDB exhibits robust capitalisation on two levels. Its own resources (paid-in capital and reserves) are sizeable in relation to its risky assets (defined by us as the bank's exposure to non-investment grade countries). These own resources are supported by contingent resources in the form of callable capital, a substantial part of which is owed by highly rated, non-regional countries. In 2010, the GCI-VI strengthened the bank's capital adequacy ratios even further (see below). The GCI-VI, which will triple the bank's capital to nearly \$100 billion or close to SDR68 billion, will be paid-in over 12 years for regional member countries that are only eligible to borrow from the African Development Fund and eight years for the others members. Among 73 countries that accepted GCI-VI, only Kuwait did not deposit its instrument of subscription. Subscriptions become effective after the full payment of the first instalment. 66 countries paid their first instalment at the end of June 2012 and 5 after the due date. Shares that are not allocated can be purchased by other members, which ensures that the bank will generally get paid. A minimal number of shares have already been re-allocated this way. There is also an advance-payment scheme which offers a small discount to countries but is neutral to the bank. Spain paid its contribution in a single payment. Mauritius, Canada and Denmark have also started paying under the accelerated scheme. In addition, Turkey will be a new member with a shareholding of about 0.34%. As illustrated by the Exhibit 3, subscribed capital has jumped to \$100 billion in 2012, from \$36.8 in 2010 and \$57.3 billion in 2011. As of June 2013, only 15,878 shares remain available for subscription.



EXHIBIT 3

## AfDB's subscribed capital over time



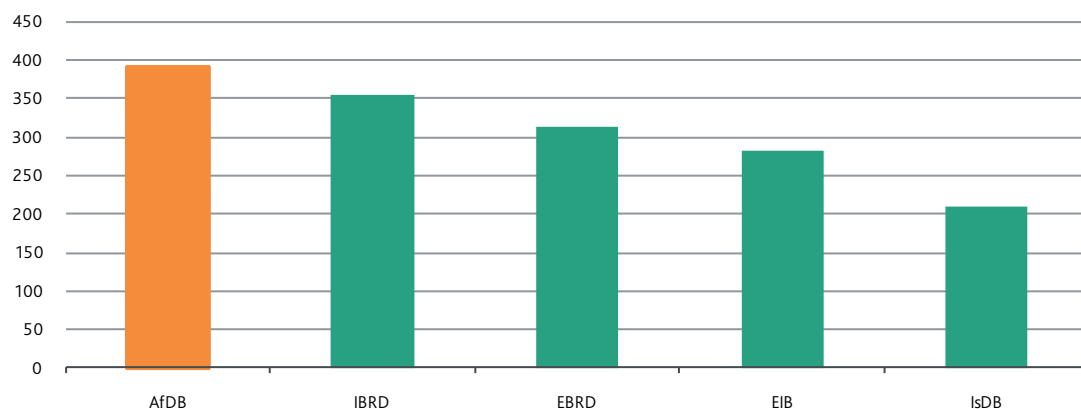
Source: AfDB, Moody's

At the end of 2012, the AfDB's usable capital (the sum of paid-in capital, general reserves and net income for the year) was SDR5.34 billion, compared with SDR4.88 billion in 2011. The AfDB's subscribed capital was also SDR65.22 billion, of which only 7.6% was actually paid-in. This was significantly higher than SDR23.9 billion recorded at the end of 2010 as new shares were created for the GCI. Over the next few years, subscribed capital could potentially close the small gap and reach SDR67.6 billion as the last remaining subscriptions to the GCI become effective. The AfDB's general reserves, which have been built up over time through retained earnings, amounted to SDR2.7 billion at the end of 2012. The bank's ability to add an extra SDR1.15 billion over the past decade to strengthen its capital base is supportive of its rating. Overall at the end of 2012, the AfDB's own resources (which totalled SDR5.34 billion) were equivalent to (1) 48% of all its outstanding loans, compared with 53% in 2011; and (2) 82% of its risky assets, compared with 86% in 2011. The latter ratio was 89.6% for the World Bank and 117.8% for the Islamic Development Bank (both Aaa-rated) at the end of 2012.

When assessing the level of capitalisation of MDBs, we include callable capital. Callable capital is a full-faith credit obligation of member states to the bank, although the likelihood that this obligation is honoured varies depending on the credit quality of each government. We calculate enhanced capital ratios incorporating only callable capital owed by governments rated Aa3 and above. For the AfDB, this includes 18 governments, all non-regional, which together account for 44% of the AfDB's subscribed capital at the end of 2012. It includes the US, Japan, Canada, France, the UK, Germany and Sweden.

The sum of the AfDB's usable capital and callable capital owed by governments rated Aa3 and above was SDR22.3 billion. This is equivalent to almost 2.5x the total amount of its risky assets at SDR9.1 billion defined as the total of loans in non-investment grade countries and all equity investments. The effect of the GCI has been substantial as the same ratio reached 200% at the end of 2010. According to this measure, the AfDB's capitalisation level is now higher than that of other major MDBs such as the Islamic Development Bank (210%) and close to the high value of 354% for the World Bank or IBRD. In absolute and relative terms (see Exhibit 4 below), the coverage of risky assets by sound capital is very high, and provides considerable protection to bondholders against even the most severe scenarios.

EXHIBIT 4

**Usable Capital + Callable Capital of Aaa/Aa Members as % of Risk Assets (as of December of 2012)**

Source: AfDB, IBRD, EIB, EBRD, IsDB, Moody's

The AfDB operates under a self-imposed capital adequacy framework, which combines (1) prudential limits on the amount of outstanding loans (weighted by risk class according to the AfDB's internal rating scale) in relation to usable capital; and (2) limits on the amount of its own borrowings in relation to different aggregates of capital. The internally prescribed limit on borrowing is expressed as follows: total debt cannot exceed 100% of usable capital (the AfDB's definition: equity and reserves plus callable capital owed by countries rated A3 and above). After a peak at 84% in 2010, this ratio decreased to 55% at the end of 2011 and 50% by the end of 2012. However the ratio should steadily increase again as the bank expands its balance sheet. One measure of leverage is the ratio of total borrowings to subscribed capital plus general reserves. Reflecting the bank's medium-term strategy and crisis-related lending, this ratio increased substantially to 0.45x at the end of 2010, from 0.3x in 2008. Following the GCI, it went down to 0.3x again in 2011 and to 0.2x in 2012. The AfDB compares well relative to its peers. For example, the World Bank had a ratio at 0.6x, while the European Bank for Reconstruction and Development and the European Investment Bank had more leveraged ratios at 1.5x and 1.6x respectively. In our opinion, subject to the AfDB maintaining adequate liquidity, the size of its borrowing is not in itself credit negative.

The AfDB's risk capital utilisation rate (58.0% in 2012) should not breach the 100% limit before 2021 as the GCI should provide adequate capital headroom to sustain medium-term growth in the bank's portfolio. The bank's goal is to sustain level of lending at SDR3.6 billion per year over the next decade. Overall, we believe that the bank is capable of fully accommodating its currently ambitious expansion plans whilst maintaining robust capital adequacy consistent with a Aaa rating.

## Asset Composition and Quality

### Treasury assets

AfDB's treasury assets consist of trading assets and investments held at amortised cost. At the end of 2012, they amounted to SDR7.4 billion, of which trading assets accounted for SDR3.6 billion. The latter are very liquid as 50% has a maturity of less than 6 months. A large portion of treasury assets (50%) were invested in government, government-guaranteed, supranational and agency securities. In addition, the credit quality was very strong despite the European downgrades as 93% of the portfolios was made of assets rated Aa3 or better (the rest were A-rated and 1% below A) at the end of December 2012. The bank has no exposure to Greece or Ireland and at the end of December 2012 had only SDR71 million exposure to stressed euro area countries split between Spain and Spanish entities with SDR31.3 million, Portugal with SDR1.3 million and Italy with SDR38.1 million.

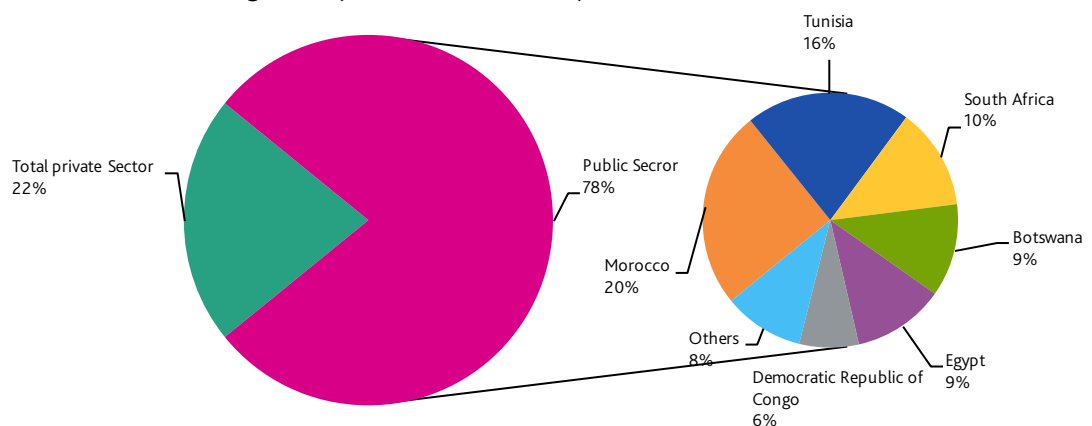
### Development-related assets

Looking at portfolio dynamics, growth in the sovereign portfolio reached 14% in 2012, compared with 13% in 2011, while the private-sector portfolio grew by 30%, compared with 14% in 2011. The total loans outstanding on the public sector and charges receivables was SDR8.6 billion at the end of 2012, compared with SDR2.4 billion for the private sector. The bank's baseline scenario foresees its future lending reaching SDR3.6 billion annually, with an average credit quality in line with the current portfolio quality. The financial sector is the dominant sector in both sovereign and non-sovereign portfolios.

The AfDB has developed its own rating scale, in which credit quality is assessed on a 22-grade scale ranging from "1+", "1", "1-" to 10 where "1+" is the highest quality corresponding to at least an A1 and above on our rating scale. On this internal scale, the weighted-average risk rating of its development-related loans is 2.62 at the end of 2012, below the target of 3 to 4. This internal rating is approximately equivalent to a rating of Ba1 on our global scale. In 2011, the deterioration of the AfDB's overall portfolio quality was mainly the result of downgrades of sovereign borrowers and the revision of the bank's adequacy framework, including its scale. However this has been offset by first-time borrowings of highly rated sovereigns, such as Botswana and South Africa. The latter improved the overall quality of the portfolio, although they did not reduce the actual amount of risk that the AfDB carries on its books. Instead, this risk is likely to increase as a consequence of an accelerated increase in lending to private-sector counterparties that exhibit, on average, substantially inferior creditworthiness than AfDB's sovereign borrowers. At end-2012, the private-sector portfolio was rated 3.47 by the AfDB, compared with 2.38 for the sovereign portfolio.

EXHIBIT 5

#### % of Total Outstanding Loans (as of December 2012)



Source: AfDB, Moody's

Asset quality is the main – and arguably the only significant – credit challenge that the AfDB faces on its loan portfolio. This results from the weak economic and financial operating environment and the political instability in some member countries. Of the 53 African countries in which the AfDB can operate and of the 16 governments to which it can extend sovereign loans, only four Botswana (A2 stable), Mauritius (Baa1 stable), Namibia (Baa3 stable) and South Africa (Baa1 negative) have achieved investment-grade status.

AfDB's portfolio is therefore relatively concentrated, since the top-five borrower countries accounted for 64% of the outstanding loans at the end of 2012. More importantly, the regional concentration in the portfolio is high as North Africa still dominates the portfolio. With the political uncertainty associated with the Arab Spring, the AfDB is more vulnerable than it has been historically. Exhibit 6

shows exposure per country in this region, excluding Libya where the bank has no operations. Although almost 50% of the bank's portfolio is in countries currently undergoing political transitions, this exposure is small compared with the size of the bank's balance sheet, especially after the GCI-VI in 2010. We will monitor the situation closely, as further political turmoil could lead to losses, although these would be manageable by the bank. Under stress scenarios where North African countries are downgraded and even default with losses exceeding 50%, the risk capital utilisation rate (RCUR) would deteriorate significantly but remain below 100%. However the limit would be reached much sooner than envisage in the medium-term strategy that would therefore be impaired. At end-2012, risk capital used for the whole portfolio was SDR3.1 billion, equivalent to a RCUR of 58.0%. North Africa risk capital used amounted to 23% of risk capital used for DRE operations at the end of June 2013. This should continue to increase over the years, especially if the approved loans are disbursed or if internal ratings are downgraded. North African countries have remained current on their loan repayments even during the height of the revolutions.

## EXHIBIT 6

**AfDB's sovereign exposure on North African countries at 31 Dec 2012 (SDR million)**

Countries in North Africa	Loans Outstanding	Undisbursed balance	Of Total Sovereign Outstanding
Algeria	0	0	0
Libya	0	0	0
Egypt (Caa1, negative)	1,000	638	11.6%
Morocco (Ba1, negative)	2,166	970	25.1%
Tunisia (Ba2, negative)	1,798	470	20.9%
Total North Africa	4,964	2,079	57.6%
Total AfDB	8,617	3,635	100%

Source: AfDB

MDBs usually benefit from an enhancement of the credit of their loan books deriving from their preferred-creditor status (PCS). This refers to the accepted practice whereby sovereign governments generally rank their obligations vis-à-vis supranational institutions senior to other debt obligations. For the AfDB, this enhancement is comparatively limited, for two reasons. Firstly, PCS does not apply to private-sector exposure and therefore its value to the AfDB could become more limited as private-sector loans increase. Secondly, PCS does not by itself represent credit insurance. The AfDB has experienced several incidences of sovereign borrowers defaulting or remaining in arrears on their loans for extended periods. These defaults and arrears were mostly related to lack of financial capacity from the borrowers than a lack of willingness to repay the bank.

Fortunately for the bank, as a consequence of different debt-relief initiatives funded by donor countries and the arrears-clearance mechanisms, the AfDB's assets have improved considerably. At the end of 2012, cumulated total impairment provisions on principal and charges, stood at SDR326 million, which represented 3.0% of total loans and charges. The remaining stock of arrears essentially consists of 96% of sovereign operations that failed before 1995 and includes countries such as Somalia, Sudan and Zimbabwe. Private-sector impairment on loans again slightly increased in 2012 at SDR34.96 million, while private-sector exposure grew more than 4x times to SDR2.4 billion, from SDR503 million in 2008. However, this low number may not reflect the true quality of private-sector loans, as they were generally granted with a three-year grace period. As borrowers will have to reimburse their loans in the coming years, we will be better able to judge the quality of the bank's private-sector portfolio. The private sector initiative is really effective in the fact that the AfDB estimated that each dollar has a multiplier effect of 5.3x through other financial institutions' involvement. The multiplier

is only 3.0x for operations with a sovereign guarantee. 50% of the private sector lending is directed towards low income economies.

We do not consider the high level of risk borne by the AfDB – and the still relatively high, albeit decreasing ratio of non-performing loans relative to other multilateral banks – as a rating constraint. This assessment is valid to the extent that the AfDB's capitalisation level and its risk-management policies continue to generate sufficient buffers to absorb these risks.

## Strength of Member Support

### Ability to support

The weighted-average rating of the AfDB's shareholders is Ba3. This is one of the lowest weighted averages of all Moody's-rated MDBs, but equivalent to that of the Central American Bank for Integration (CABEI) rated A2, and just below the Ba1 average of the Inter-American Investment Corporation (IIC), rated Aa2. Concerning other Aaa-rated peers, it is the lowest weighted average of all Aaa Moody's-rated MDBs, just below the Ba1 average of Inter-American Development Bank (IADB), and equivalent to the Ba3 average of the Islamic Development Bank (IsDB). At the other end of the spectrum, the Nordic Investment Bank (NIB) has the highest weighted average at Aa2 followed by the Asian Development Bank (ADB) at Baa3. The AfDB's position reflects the lack of ratings for many of its shareholders and their likely position in the single-B range or even lower.

However, we stressed that this does not accurately reflect the true ability of shareholders to support the AfDB. As many of its shareholders are still heavily reliant on foreign aid for a large proportion of their foreign-currency needs, their ability to quickly transfer callable capital to the bank in the hypothetical event of an emergency is very low. In addition, there has been a clear deterioration of the credit quality of some of the non-regional members in particular in the euro area, following the rating downgrades of Italy and Spain. However, in this remote scenario of a call on the callable capital by the AfDB, the likelihood the contractual support will materialise is very high taking into account the credit quality of the AfDB's non-regional shareholders. Aaa-rated shareholders accounted for 21.8% of the AfDB's capital as of July 2013 and 35.4% when including the share of member countries rated at least Aa3 by us.

In addition, the bank has been able to strengthen its capital structure by attracting new non-regional members over the years. While Turkey (Baa3, stable) has paid in the required share amount, Luxembourg (Aaa negative) still needs to finalize payments to effectively become a member. The inclusion of Luxembourg and Turkey will add SDR250 million in extra capital. In addition, Australia (Aaa stable) officially announced in July 2012 that it will pursue membership of the AfDB to help overcome poverty in Africa. Australia's membership will yield substantial resources as its economy exceeds \$1.5 trillion. It should become one of the largest shareholders..

### Willingness to support

The AfDB benefits from very strong support from its shareholders, illustrated by the unanimous decision to approve the sixth general capital increase. Not only is the amount substantial (tripling of the bank's capital base to \$100 billion), but shareholders are committed to sending new resources to the bank by agreeing to effectively pay 6% of the amount (the rest being callable). This reflects a stronger willingness from its shareholders to support the AfDB than experienced by many other MDBs. With the negative effects of the global financial crisis, many other MDBs (which share many of the same shareholders) found themselves in need of additional capital in order to boost their lending within their prudential frameworks. However, when these capital increase were often granted before

the global financial crisis, the MDBs concerned were generally forced to finance the paid-in capital for its shareholders from their own general reserves in lieu of their shareholders and did not receive additional resources from their shareholders beyond the increase in callable capital.

Member support can be expressed as a function of the value that the banks brings to its members, in addition to the value provided by other, larger MDBs active in the same general geographical area, or with whom it shares broadly similar membership. The AfDB has strengthened its co-operation with many of these institutions over time. The most active MDBs in Africa are the World Bank, a number of national agencies such as the Agence Française de Développement, the European Investment Bank and some other regional financial institutions. The particular nature of the AfDB as one of the main development vectors in Africa and the significance of its actions across Africa translates into very strong willingness from shareholders (both regional and non-regional) to support the bank.

The AfDB also enjoys extraordinary support from its shareholders, which was illustrated when both Canada and Korea awarded temporary capital increases to the AfDB in order to support the initiatives taken by the bank following the start of the financial crisis. These capital increases amounted to SDR1.63 billion and SDR194 million, respectively and were retired as the GCI-VI came into effect. We think that the AfDB is likely to receive some form of support from shareholders, especially if needed for the bank to better fulfill its mandate.

## Rating History

African Development Bank					
	Issuer Rating		Senior Unsecured	Outlook	Date
	Long-Term	Short-Term			
Outlook Assigned	--	--	--	Stable	Nov-03
Rating Assigned	--	P-1	--	--	Mar-00
Rating Assigned	Aaa	--	--	--	Dec-94
Rating Assigned	--	--	Aaa	--	Mar-84

## Annual Statistics

Key Financial Statement Statistics (US\$ Mils.)<sup>[1]</sup>

	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>Balance Sheet Summary</b>									
<b>Assets</b>	<b>16,760</b>	<b>16,581</b>	<b>18,552</b>	<b>19,093</b>	<b>19,363</b>	<b>26,940</b>	<b>29,483</b>	<b>31,107</b>	<b>32,605</b>
Liquid Assets	6,956	7,468	9,361	8,571	7,961	12,120	12,057	12,182	11,326
Gross Loans	8,760	7,879	7,960	8,755	8,987	11,818	12,771	14,391	16,928
Gross Equity Investments	249	241	179	299	291	368	419	476	674
Net Loans	8,137	7,318	7,303	8,178	8,651	11,461	12,335	13,926	16,427
Other	1,419	1,553	1,709	2,044	2,461	2,992	4,671	4,524	4,179
<b>Liabilities</b>	<b>10,156</b>	<b>10,323</b>	<b>11,853</b>	<b>11,653</b>	<b>12,185</b>	<b>19,507</b>	<b>22,059</b>	<b>23,612</b>	<b>24,398</b>
Borrowings	8,757	8,490	8,832	9,796	10,331	16,587	18,450	19,810	20,408
Other	1,398	1,833	3,022	1,857	1,854	2,920	3,609	3,803	3,989
<b>Capital and Reserves</b>	<b>6,605</b>	<b>6,257</b>	<b>6,699</b>	<b>7,440</b>	<b>7,178</b>	<b>7,433</b>	<b>7,424</b>	<b>7,494</b>	<b>8,207</b>
Paid-in Capital	3,438	3,235	3,465	3,692	3,613	3,684	3,628	3,847	4,364
Cumulative Exchange and Currency Adjustments	-955	-217	-234	-253	-248	-254	-250	-247	-256
Total Reserve (of which)	3,396	3,239	3,468	4,001	3,813	4,002	4,046	3,894	4,100
Reserves	3,272	2,350	2,519	2,860	2,984	3,289	3,274	3,331	3,240
Net Income	223	316	292	511	469	362	329	253	305
Loan and Equity Loss Provisions	624	561	657	576	336	356	436	465	502
<b>Capital Structure Summary</b>									
<b>Total Subscribed Capital</b>	<b>33,542</b>	<b>31,040</b>	<b>32,788</b>	<b>34,281</b>	<b>33,525</b>	<b>34,203</b>	<b>36,845</b>	<b>57,299</b>	<b>100,230</b>
<b>Less Total Callable Capital (CC)</b>	<b>30,089</b>	<b>27,681</b>	<b>29,241</b>	<b>30,565</b>	<b>29,896</b>	<b>30,505</b>	<b>33,186</b>	<b>52,250</b>	<b>92,603</b>
(CC of Aaa/Aa Countries)	11,197	10,293	10,980	11,485	11,205	11,521	11,582	24,947	32,700
(CC of Investment Grade Countries)	14,461	12,732	14,131	14,813	14,448	14,907	14,980	33,531	44,285
+/- Net Overdue or Prepaid Subscriptions	-15	-8	-4	-3	-3	-4	-1	-2	0
<b>Equals Paid-in Capital</b>	<b>3,438</b>	<b>3,352</b>	<b>3,543</b>	<b>3,713</b>	<b>3,626</b>	<b>3,695</b>	<b>3,657</b>	<b>5,048</b>	<b>7,627</b>
Less Non Negotiable Instruments Rcvd Not Yet Due	48	37	31	24	0	13	7	5	3
Plus/minus Cum. Exchange Adjust. on Subscription	-229	-217	-234	-253	-248	-254	-250	-247	-256
Less Paid-in Capital in Non-convertible Currency	179	165	173	182	177	181	177	177	0
Plus reserves and Net Income	3,396	3,239	3,468	4,001	3,813	4,002	4,046	3,894	4,100
<b>Equals Usable Equity</b>	<b>6,378</b>	<b>6,172</b>	<b>6,573</b>	<b>7,254</b>	<b>7,014</b>	<b>7,250</b>	<b>7,269</b>	<b>8,514</b>	<b>11,468</b>
<b>Loan Portfolio Summary</b>									
Approved Loans	24,833	24,869	27,215	29,756	31,206	39,396	40,457	43,586	45,662
Less Undisbursed Balance	2,361	2,658	3,054	2,560	3,928	7,838	7,477	8,138	6,860
Equals Disbursed Loans	22,472	22,211	24,161	27,196	27,279	31,558	32,979	35,448	38,802
Less Repayments	13,712	14,332	16,201	18,441	18,292	19,740	20,208	21,057	21,874
Equals Loans Outstanding	8,760	7,879	7,960	8,755	8,987	11,818	12,771	14,391	16,928

**Key Financial Statement Statistics (US\$ Mils.)<sup>[1]</sup>**

	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>Income Statement Summary</b>									
<b>Gross Income</b>	<b>705</b>	<b>710</b>	<b>859</b>	<b>912</b>	<b>884</b>	<b>856</b>	<b>805</b>	<b>715</b>	<b>871</b>
Income on Loans	497	460	492	538	542	451	451	483	539
Income on Investments	192	222	322	366	313	350	338	259	304
Other	16	28	44	7	30	55	16	-27	28
Gross Expenses	481	394	567	400	415	493	476	462	566
Interest and Financial Expenses	306	310	422	523	489	365	272	314	334
Unrealized net gains on non-trading derivatives	--	34	-48	-89	7	5	63	5	16
Provisioning for Loan and Equity Investment Losses	79	-21	130	-110	-164	16	14	18	45
Administrative Expenses	58	60	55	67	72	99	115	122	161
Other	11	11	7	9	11	9	11	4	10
<b>Net Income</b>	<b>224</b>	<b>111</b>	<b>82</b>	<b>322</b>	<b>73</b>	<b>107</b>	<b>104</b>	<b>79</b>	<b>136</b>

**Performance Statistics (%)**

Return on Total Assets	1.4	0.7	0.5	1.7	0.4	0.5	0.4	0.3	0.4
Return on Earning Assets	1.4	0.7	0.5	1.8	0.4	0.5	0.4	0.3	0.5
Return on Equity <sup>[1]</sup>	3.5	1.8	1.2	4.4	1.0	1.5	1.4	1.1	1.7
Interest on Loans/Loans Outstanding	5.6	5.8	6.1	6.1	6.0	3.8	3.4	3.3	3.1
Interest Coverage Ratio (x)	1.7	1.4	1.2	1.6	1.1	1.3	1.4	1.3	1.4
Loans in Non-accrual as % of Paid-in Capital	31.6	30.0	28.5	25.7	11.7	11.5	13.2	9.3	6.3

**Capital Adequacy Ratios (%)**

Usable Equity as % Risk Assets	93.3	100.8	107.9	103.9	95.3	79.8	77.3	86.1	101.8
Usable Equity + CC of Aaa/Aa Members as % Total Loans Outstanding	200.6	209.0	220.5	214.1	202.7	158.8	147.6	232.5	260.9
Usable Equity + CC of Aaa/Aa Members as % Risk Assets	257.1	268.8	288.1	268.3	247.5	206.7	200.4	338.4	391.9
Usable Equity + CC of IG Members/Risk Assets	304.8	308.6	339.9	315.9	291.6	243.9	236.5	425.2	494.7

**Liquidity Ratios (%)**

Liquid Assets (incl. Special Reserve)/Total Assets	41.5	45.0	50.5	44.9	41.1	45.0	40.9	39.2	34.7
Liquid Assets (incl. Special Reserve)/Total Borrowings	79.4	88.0	106.0	87.5	77.1	73.1	65.3	61.5	55.5
Liquid Assets (excl. Special Reserve)/Undisbursed Loans	294.7	280.9	306.5	334.8	202.7	154.6	161.3	149.7	165.1

**Coverage of Debt Service (%)**

Liquid Assets as % CMLTD plus Interest Paid	500.0	569.5	635.9	303.1	326.3	428.3	364.9	250.1	203.1
Liquid Assets + Net Income + Interest Paid									
as % CMLTD + Interest Paid	538.1	601.6	670.2	333.0	349.3	445.1	376.3	258.2	211.6
Liquid Assets + Net Income + Interest Paid									
as % Interest Paid	2445.9	2542.3	2337.6	1801.6	1742.2	3446.9	4567.0	4002.1	3532.7



Key Financial Statement Statistics (US\$ Mils.)<sup>[1]</sup>

	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>Maturity Distribution of Outstanding Borrowings (% of Total)</b>									
CMLTD	12.4	11.8	11.9	23.5	18.9	14.9	16.4	23.0	25.7
One Year to Two	7.3	5.9	18.5	15.2	17.7	14.7	21.5	18.9	15.4
Two to Four	24.5	25.3	30.9	20.2	11.0	34.8	38.0	23.0	27.1
More than Four Years	63.0	57.1	38.8	41.1	52.5	35.7	24.1	35.2	31.9

[1] From 2004, all figures are restated for compliance with IFRS.

## Capital Subscriptions and Voting Power (as of 31 December 2012, in SDR million)

	Subscribed Capital <sup>[1]</sup>			Voting Power	
	Percent of Total	Total	Callable	Paid-In	Percent of Total
<b>Regional Member Countries</b>					
Nigeria	9.33	5,889.26	5,635.85	253.41	9.27
Egypt	5.40	3,408.54	3,263.49	145.05	5.37
Côte d'Ivoire	3.71	2,342.99	2,233.62	109.37	3.70
Algeria	4.23	2,666.76	2,556.52	110.24	4.21
Libya	4.06	2,558.83	2,451.69	107.14	4.04
Morocco	3.51	2,214.44	2,108.99	105.45	3.49
Zimbabwe	2.07	1,303.87	1,243.75	60.12	2.06
Ghana	2.28	1,437.58	1,377.32	60.26	2.27
Botswana	1.09	689.27	632.85	56.43	1.09
Others	19.63	12,385.97	11,808.34	577.63	19.90
<b>Total Regional Developing Member Countries</b>	<b>60.15</b>	<b>37,949.60</b>	<b>36,261.69</b>	<b>1,687.91</b>	<b>60.21</b>
<b>Non-Regional Member Countries</b>					
United States of America	6.63	4,182.51	4,016.22	166.29	6.59
Japan	5.52	3,484.71	3,329.18	155.53	5.49
Germany	4.12	2,602.39	2,499.14	103.25	4.10
Canada	3.83	2,415.21	2,276.56	138.65	3.81
France	3.78	2,382.91	2,276.56	106.35	3.76
Others	15.97	10,074.50	9,593.01	481.49	16.04
<b>Total Non-Regional Member Countries</b>	<b>39.85</b>	<b>25,142.23</b>	<b>23,990.67</b>	<b>1,151.56</b>	<b>39.79</b>
<b>Grand Total</b>	<b>100.00</b>	<b>63,091.83</b>	<b>60,252.36</b>	<b>2,839.48</b>	<b>100.00</b>

[1] Include temporary non-voting capital increase from Canada and Korea

## Moody's Related Research

### Credit Analyses:

- » [Council of Europe Development Bank, September 2013 \(158015\)](#)
- » [Arab Petroleum Investments Corporation, September 2013 \(157489\)](#)
- » [Fondo Latinoamericano de Reservas \(FLAR\), September 2013 \(157920\)](#)
- » [Corporacion Andina de Fomento September 2013 \(157733\)](#)
- » [Shelter-Afrique, August 2013 \(157912\)](#)
- » [Central American Bank for Economic Integration \(CABEL\), August 2013 \(156304\)](#)
- » [European Investment Bank \(EIB\), August 2013 \(156691\)](#)
- » [Black Sea Trade and Development Bank, July 2013 \(156365\)](#)
- » [European Bank for Reconstruction & Development \(EBRD\), July 2013 \(156313\)](#)
- » [East African Development Bank, June 2013 \(155458\)](#)
- » [Nordic Investment Bank, June 2013 \(155760\)](#)
- » [Asian Development Bank, May 2013 \(153552\)](#)
- » [Inter-American Investment Corporation, March 2013 \(151642\)](#)
- » [Inter-American Development Bank, March 2013 \(151481\)](#)
- » [Eurofima, February 2013 \(149683\)](#)
- » [IBRD \(World Bank\), January 2013 \(148642\)](#)
- » [Islamic Development Bank \(IsDB\), October 2012 \(146140\)](#)

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## Related Website

- » African Development Bank, [www.afdb.org](http://www.afdb.org)

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» contacts continued from page 1

### Analyst Contacts:

**NEW YORK** +1.212.553.1653

Kristin Lindow +1.212.553.3896  
*Senior Vice President*  
 kristin.lindow@moodys.com

Bart Oosterveld +1.212.553.7914  
*Managing Director - Sovereign Risk*  
 bart.oosterveld@moodys.com

Report Number: 158743

**Author**  
 Aurelien Mali

**Editor**  
 Shem Pennant

**Associate Analyst**  
 Stefan Triendl

**Production Specialist**  
 Cassina Brooks

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