CREDIT OPINION
28 August 2018

African Development Bank - Aaa Stable
Regular update

Summary
The AfDB’s credit profile is supported by the bank’s long track record as the prime development institution in the region that benefits from very high regional and non-regional member support and from its preferred creditor status. Its prudent liquidity policy mitigates the bank’s challenging operating environment as highlighted by asset quality challenges in the non-sovereign portfolio, deteriorating leverage ratios, and by downward pressures on the bank’s weighted average borrower rating.

Exhibit 1
AfDB’s credit profile is determined by three factors

<table>
<thead>
<tr>
<th>Capital Adequacy</th>
<th>Liquidity</th>
<th>Strength of Member Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>Very High</td>
<td>Very High</td>
</tr>
</tbody>
</table>

Intrinsic Financial Strength (F1 + F2)
Very High

Rating Range (F1 + F2 + F3)
Aaa-Aa2

Source: Moody’s Investors Service

Credit strengths
» Robust, albeit deteriorating capital adequacy
» Very strong liquidity position
» Very high debt coverage of callable capital and preferred creditor status

Credit challenges
» Medium asset quality in comparison with Aaa-rated peers

This report was republished on 4 September 2018 to address a currency conversion in the total assets which appears in the key indicators table on page 2.
A challenging operating environment reflected in non-sovereign asset quality trends

Deteriorating weighted average borrower rating following sovereign downgrades

**Rating outlook**

The stable outlook reflects the bank’s preferred creditor track record in the sovereign segment, in addition to capital and liquidity buffers that remain comparable with Aaa peers, despite the deteriorating operating environment and asset quality challenges. The stable outlook also reflects our expectation that the bank’s very high shareholder support will materialize in the expected general capital increase exercise with payment installments starting 2020 in order to support the bank’s capital adequacy buffers and fund the bank’s planned medium-term development strategy.

**Factors that could lead to a downgrade**

A continuation of the deteriorating capital and leverage ratios, or lack of shareholder support to contribute to future capital increases aimed at funding the bank’s development strategy would be credit negative, as would a significant deterioration in asset quality driven by a weaker operating environment.

**Key indicators**

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<tbody>
<tr>
<td>Total Assets (USD million)</td>
<td>32,605</td>
<td>32,335</td>
<td>33,251</td>
<td>35,124</td>
<td>39,963</td>
<td>46,108</td>
</tr>
<tr>
<td>Return on Average Assets (%)</td>
<td>0.4</td>
<td>0.4</td>
<td>0.1</td>
<td>-0.1</td>
<td>0.1</td>
<td>0.6</td>
</tr>
<tr>
<td>Usable Equity/Gross Loans Outstanding + Equity Operations (%) [1]</td>
<td>46.6</td>
<td>48.1</td>
<td>45.9</td>
<td>47.0</td>
<td>41.1</td>
<td>38.1</td>
</tr>
<tr>
<td>Gross NPLs/Gross Loans Outstanding (%) [2]</td>
<td>2.8</td>
<td>2.9</td>
<td>3.1</td>
<td>4.1</td>
<td>3.4</td>
<td>2.4</td>
</tr>
<tr>
<td>ST Debt + CMLTD/Liquid Assets (%) [3]</td>
<td>56.2</td>
<td>36.8</td>
<td>16.4</td>
<td>42.2</td>
<td>33.8</td>
<td>41.0</td>
</tr>
<tr>
<td>Total Debt/Discounted Callable Capital (%) [4]</td>
<td>49.9</td>
<td>47.5</td>
<td>53.7</td>
<td>60.0</td>
<td>75.6</td>
<td>94.1</td>
</tr>
</tbody>
</table>

[1] Usable equity is total shareholder’s equity and excludes callable capital
[2] Non performing loans
[3] Short-term debt and currently-maturing long-term debt
[4] Callable capital pledged by members rated Baa3 or higher, discounted by Moody’s 30-year expected loss rates associated with ratings

**Detailed credit considerations**

The AfDB’s ‘High’ **Capital Adequacy** assessment compares to a ‘Very High’ assessment at other Aaa-rated institutions and reflects mainly the AfDB’s more challenging operating environment and the higher non-performing loan track record, especially in the non-sovereign segment. The bank’s asset coverage ratio defined as usable equity/development operations at 42% and a leverage ratio at 327% performs in line with peers although both of these key ratios deteriorated significantly over 2016-17 following the sharp expansion in loan disbursements and approvals geared toward budget support. The bank’s country risk concentration metrics have improved in response to the Exposure Exchange Agreement (EEA) entered into with the International Bank for Reconstruction and Development (IBRD) and the Inter-American Development Bank (IADB) starting 2015.

The share of non-sovereign NPL ratio has improved in 2017, falling to 4.5% from 7.5% in 2016, as the total NPL ratio also improved to 2.4% in 2017 from 3.4% in 2016, still above the Aaa-rated median of 0.6%.

The AfDB’s ‘Very High’ **Liquidity** assessment is among the strongest in the Aaa-rated cohort based on a 3-year average debt service coverage ratio of 38% which is stronger than the Aaa-median at 44.9%. Its performance underscores the AfDB’s prudent liquidity policy which requires it to meet net cash-flow requirements (including debt-service payments, net loan disbursements, the notional value of committed guarantees and the value of undisbursed equity investments) over a rolling 1-year horizon without recourse to capital markets.

As a very active global benchmark issuer, the bank benefits from ample access to global and local capital markets at very favorable terms, and from a large and diversified investor base across regions and local currencies.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
The AfDB’s **Strength of Member Support** assessment is ‘Very High’. In addition to the AfDB’s own financial resources, the AfDB could draw on the callable capital support from its shareholder governments. This large group includes many highly rated non-regional governments, including the G7. Despite the AfDB’s below investment grade weighted median shareholder rating, the AfDB’s debt/discounted callable capital ratio remains robust, just above the median for Aaa-rated MDBs in our rated universe, underscoring the Bank’s very high contractual shareholder support. In addition, shareholders’ very high propensity and priority of support in response to the AfDB’s role as one of the main forces for development in Africa contribute to the Bank’s ‘Very High’ strength of member support assessment.

**Recent developments**

**Leverage continues to rise as the AfDB stretches to meet its mandate**

The AfDB’s debt-to-equity ratio rose to 327% at the end of 2017, remaining on an upward trend since 2014, when the ratio stood at 244%. Approximately $9 billion of debt was raised in 2017, including with two global benchmark issuances, a 5-year $2 billion, and a 3-year $2.5 billion bond issue. As of end-June 2018, the AfDB has completed approximately 60% of its established borrowing program for the year, of $8 billion. In 2017 loan disbursements reached UA 3.7 billion, roughly equivalent to $5.2 billion, and compared with UA 3.2 billion in 2016, as the AfDB sought to support a region still facing economic and financial market pressures. While the public sector constituted 78.1% of total outstanding loans, the AfDB aims to increase the private sector share to 25% from its current 21.9%.

The AfDB’s liquidity metrics remaining strong overall, while its debt service coverage saw some deterioration in 2017, to 41% in 2017 from 41% in 2016. At 41%, it has moved closer to the Aaa median of 46% in 2017. AfDB maintains robust prudential requirements, and has historically maintained an actual liquidity level above what its risk management calls for, currently having a 1-2 year liquidity buffer.

**Pace of capital adequacy deterioration has slowed in 2017 after a strong decline in 2016**

While the AfDB’s capital adequacy ratios remain within the ranges of Aaa-rated peers, key ratios have continued to deteriorate in 2017. Specifically, the bank’s asset coverage ratio declined to 37.9% in 2017, which followed a six percentage point decline to 40.9% in 2016. This deterioration was more than was witnessed over the 2011-2015 period combined. The Bank’s internal measure of capital adequacy was expected to reach a trigger for a capital increase in 2018, but the slowdown in credit growth has caused an adjustment to these forecasts, with the AfDB now expecting to reach this threshold by 2020.

**Authorization to launch seventh General Capital Increase (GCI) reflects very high member support**

In May 2018, the AfDB received authorization from the Bank’s Governors to launch discussions on a seventh General Capital Increase (GCI VII), through which the AfDB aims to double existing capital levels as part of its effort to achieve its development mandate. Assuming the process proceeds as planned, the AfDB expects the terms to be concluded in mid-2019, with the first capital payments occurring in 2020, though there may be delays to this process. The level of the capital increase will impact the AfDB’s lending moving forward, with the expectation that that quantum of subsequent loan portfolio expansion would depend on the amount of capital raised. The AfDB has witnessed considerable demand from member countries to take up shares which remain unsubscribed, with allocation taking place as part of an ongoing share transfer exercise. Our baseline scenario doesn’t expect GCI VII to have any shortfalls in members subscribing to their respective capital allocations, but the high level of demand for unsubscribed allocations offers additional support should a modest shortfall arise.
Rating methodology and scorecard factors

Rating Factors - African Development Bank

<table>
<thead>
<tr>
<th>Rating Factors</th>
<th>Factor Weight</th>
<th>Factor Score</th>
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</thead>
<tbody>
<tr>
<td>Factor 1: Capital Adequacy</td>
<td>60%</td>
<td>High</td>
</tr>
<tr>
<td>Factor 2: Liquidity</td>
<td>40%</td>
<td>Very High</td>
</tr>
<tr>
<td>Intrinsic Financial Strength (F1 + F2)</td>
<td>Preliminary Rating Range</td>
<td>Very High</td>
</tr>
<tr>
<td>Factor 3: Strength of Member Support</td>
<td>+3, +2, +1, 0 notches</td>
<td>Very High</td>
</tr>
<tr>
<td>Rating Range (F1 + F2 + F3)</td>
<td></td>
<td>Aaa-Aa2</td>
</tr>
<tr>
<td>Assigned Rating</td>
<td></td>
<td>Aaa</td>
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</tbody>
</table>

**Note:** While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range.

For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

**Footnotes:**

1. **Rating Range:** Factor 1, Capital Adequacy, and Factor 2, Liquidity, combine according to the weights indicated into a construct we designate as Intrinsic Financial Strength (IFS). A notching system combines IFS and Factor 3, Strength of Member Support.

2. **5 Ranking Categories:** Very High, High, Medium, Low, Very Low.

**Moody's related publications**

- **Issuer In-Depth:** African Development Bank – Aaa stable: Annual credit analysis, 16 October 2017
- **Rating Methodology:** Multilateral Development Banks and Other Supranational Entities, 29 March 2017

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