Khula Enterprise Finance Ltd

2007 Annual Report

"Never underestimate the power of dreams and the influence of the human spirit.
We are all the same in this notion: The potential for greatness lives within each of us."
Wilma Rudolph

KHULA
enterprise finance ltd

Khula Enterprise Finance Limited

Registration No 1995/011258/06

(Incorporated in the Republic of South Africa)

Contents

We understand that as an entrepeneur or small business,
taking your business to the next step is challenging.
The keyhole symbolises you and your potential,
and the key our guidance and support.
We'll open doors for you.

Corporate Purpose

As the flagship development finance institution focussing on small businesses, Khula Enterprise Finance Limited has for more than 10 years operated as a financial facilitator for the development of the rapidly growing Small and Medium Enterprises (SME) sector of the South African economy.

The Company is a wholesale finance institution that has well-developed ties in the public and private sectors. Through these channels - which include commercial banks, retail financial institutions, specialist funds and joint ventures in which Khula has shareholdings - the Company plays an effective role as a complementary financial institution, bridging finance gaps that are not addressed by commercial financial institutions in the development of the small business sector.

Established in 1996 as an independent agency of the Department of Trade and Industry, Khula has reinforced its reputation as a primary force in the growth of the SME sector. It has achieved this by adapting to prevailing market forces within the sector and changing its approach to meet the demands of what has become an increasingly valuable sector in the development and growth of the South African economy.

Our Vision

To be the development finance partner of first choice in SME development.

Our Mission

To provide finance, mentorship services and small business premises to SMEs through a network of partnerships and to encourage the sustainable development of SMEs whilst ensuring that Khula remains financially viable.

Company Profile

Our Values

Khula is committed to adhering to the highest standards of corporate governance and operating in a sustainable manner. We adhere to the Company's code of ethics and values that govern our interactions with colleagues, external suppliers and business channels. We are committed to the following values:

- We lead with integrity
- We care about people
- We are passionate about our customers
- We communicate openly and honestly with all our stakeholders
- We drive for results

Khula Board of Directors

Nomonde Mapetla
Chairperson

Mthembeni Mkhize
Deputy Chairperson

Xola Sithole
Managing Director

Nkosana Mashiya

Dennis Thabaneng

Noah Greenhill

Wabo Msizi

Granny Mokoena

Yvonne Benn

Mandisa Manjezi

Nicky Lala-Mohan

Ismail Tayob

Mandisa Zungu

Khula Executive Management

Managing Director
Xola Sithole

Company Secretary
Bheki Dlamini

Chief Financial Officer
Tracy McDonald

Chief Operations Officer
Zukile Nomafu

Acting - GM Marketing & Corporate Affairs
Mkhululi Mazibuko

GM Risk & Compliance
Des de Jager

Khula Enterprise Finance Limited
2007 Highlights

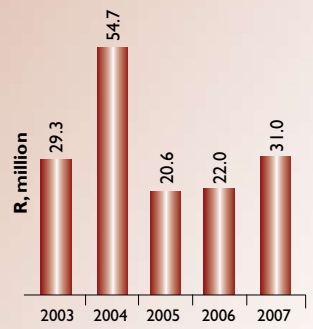
Operational Highlights

- Approvals to Khula channel partners increased to a record of R746 million (2006: R462 million), representing an increase of more than 60% over the period;
- Business loan approvals to RFIs contributed 40% of the total funds approved (2006: 14%), and for the first time exceeded approvals of the credit indemnity product distributed by banks which were at 36% (2006: 50%);
- Disbursements to our channel partners increased to R343 million (2006: R329 million);
- 65% and 32% of the funds disbursed by our intermediaries were directed to black and women owned enterprises, respectively.

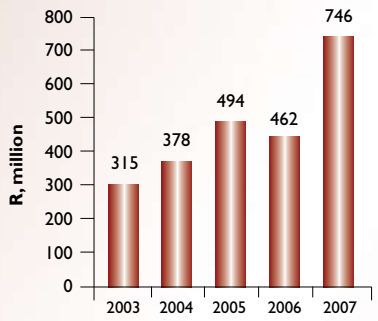
Financial Highlights

- Net profit grew to R31 million (2006: R22 million) – an increase of R9 million (41%);
- Revenue increased to R37 million representing a 26% growth;
- The value of the investment property portfolio grew by 6% to R151.5 million from R142.8 million in 2006.
- There was a significant improvement in the return on the investment earned on our property portfolio from 10% in 2006 to 16% in 2007.
- The total loan book increased by 22%, driven by a solid 30% growth in the business and equity loan book.
- Core business commitments at year end totaled R467 million.
- The capital base grew to just below R1.2 billion from R1.1 billion in 2006.

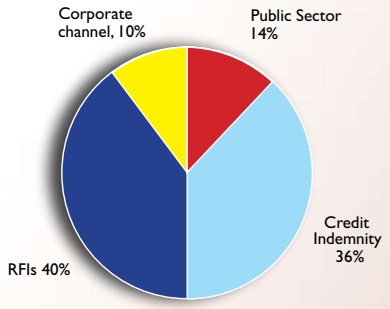
Net income after tax



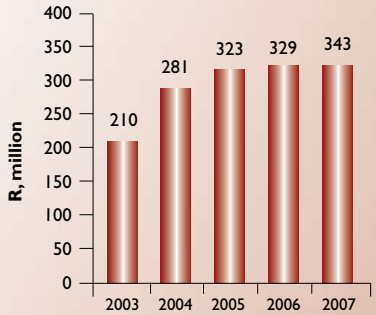
Approvals to Intermediaries



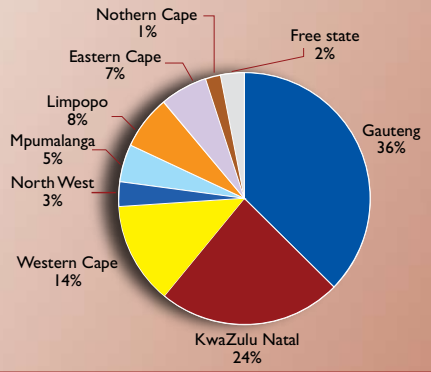
Approvals to Intermediaries per product



Disbursements to Intermediaries



Disbursements to end-users per province



Khula Enterprise Finance Limited
Five Year Summary

	2007 -2006 Increase/ (decrease)	2006 -2005 Increase/ (decrease)	**2007**	2006	2005	2004	2003
Consolidated balance sheet (R'000)							
Capital and reserves	3.1%	2.2%	**1,044,426**	1,013,404	991,402	970,844	585,782
Total assets	4.9%	2.3%	**1,167,699**	1,113,223	1,087,755	1,063,107	780,195
Cash and cash equivalents	4.4%	8.0%	**661,431**	633,844	587,146	620,988	673,665
Consolidated income statement (R'000)							
Revenue	25.7%		**176,509**	140,409	126,010	198,221	94,545
Net profit	41.0%	7.0%	**31,023**	22,001	20,558	54,681	29,346
Ratios							
Effective tax rate	-16.7%	19.6%	**18.9%**	22.7%	19.0%	23.2%	28.8%
Return on opening shareholders' interest	40.9%	4.8%	**3.1%**	2.2%	2.1%	9.3%	5.3%
Return on average assets	35.0%	4.6%	**2.7%**	2.0%	1.9%	5.9%	3.9%
Operating expenditure/total income	-1.9%	-0.1%	**78.3%**	79.8%	79.9%	64.1%	56.4%
Net profit percentage	12.1%	-3.3%	**17.6%**	15.7%	16.2%	27.6%	31.0%
Claims paid percentage	4.5%	22.0%	**4.6%**	4.4%	3.6%	7.5%	5.9%
Claims provision percentage	2.1%	27.8%	**24.7%**	24.2%	19.0%	35.8%	27.5%
Bad debts provision percentage	290.9%	-60.5%	**8.6%**	2.2%	5.5%	21.8%	34.9%
Debt/equity ratio	20.4%	1.3%	**11.8%**	9.8%	9.7%	9.5%	33.2%

Chairperson's Statement

Ms Nomonde Mapetla
Chairperson

The Government of South Africa – and the Department of Trade and Industry in particular – has constantly stated that our second decade of democracy will be concentrated on closing the gap in South Africa's dual economy.

This is in the interest of economic growth and prosperity for all, especially those members of the class of emerging entrepreneurs who will be the employers of the future. It is here that Khula Enterprise Finance Ltd plays an increasingly important role – in maximising access to finance for small enterprise development in South Africa.

Key to the achievement of this strategy is the need to encourage more women to enter the sector as owners of businesses, the development and continued growth of black-owned small businesses. An important allied drive is the need to create prosperity and business growth in under-serviced rural areas so that poverty can be addressed where it is most rife.

It is therefore particularly gratifying to see that the financial year under review was a positive one for Khula. Funding approvals totalled R746 million (2006: R462 million) for SME development, a gratifying result which can be attributed directly to the commitment by Khula and its channel partners to adopt the new strategic approach of the Company to its core business and, by so doing, match and anticipate the needs of a dynamic and changing SME market.

Key areas that contributed to Khula's positive financial performance were:

- The commitment to meeting Khula's mission, which was primarily driven by management's belief that the Company's future lay in assuming an increasingly active role in delivering value across broader market segments. This change in strategic direction involved an examination of all facets of Khula's business. Target markets, operational models, the identification of new financial delivery channels, partnerships and products were all placed under the spotlight.
- Better controls, increased levels of risk management and governance became major considerations in the drive to ensure that Khula, once it realigned its market strategy, could ensure its sustainability and future growth. A focus on strong "back office" support and systems, as well as Khula's presence in various provinces and its ability to reach provincial target audiences completed a comprehensive strategic analysis process.
- Increased profitability, which was achieved by adopting more stringent and effective lending practices. This repositioned Khula from being a "hands-off" provider of wholesale finance to an active participant with its channel partners in the development of a healthy SME sector.

Environment within which Khula operates

The positive developments within Khula, backed by sound financial achievements, have set a foundation for Khula playing an increasingly important role in the SME sector. However, as the Company operates in a dynamic and ever-changing arena, a long journey still lies ahead. Khula, along with other players in the sector, will need to address major challenges before its ultimate goal is achieved. Some of the challenges, which lie ahead, are:

- Addressing South Africa's poor national record for early entrepreneurial activity. This disturbing fact emerged from recent research published by the Global Research Monitor, of which Khula was part-sponsor, that revealed that South Africa is currently ranked 25th out of 35 countries that were measured for early entrepreneurial activity. In addition, the country also had the lowest entrepreneurial activity rate of all participating developing countries.
- The impact of the HIV/AIDS pandemic. The impact of the pandemic cannot be underestimated as it has a direct bearing on the ability of the country to build a thriving entrepreneurial class, which is a decisive factor in the direct creation of jobs and creating further indirect opportunities for growth within the sector.
- Financial institutions that are still very risk averse. This is reflected in lending patterns that currently favour SME businesses that are relatively established and therefore present a lower risk profile to the lender. This, in turn, results in funds not reaching the SME sector at the scale required, despite the requirements of the Financial Sector Charter, which sets targets in this regard and was agreed by government and the banking sector. It is a fact that many of these targets can be met and exceeded without "making a dent" in the underserved SME market – a view confirmed by the 2005 review of the Financial Service Charter Council.
- The recently introduced National Credit Act will not have a material impact on Khula. However, the current trend of rising interest rates, although impacting positively on income streams from Khula's property and other investments, could negatively affect emerging entrepreneurs by driving up costs and restricting cash flows.

Looking towards the future

Khula has made impressive strides during the last ten years, but we are commited to making further significant strides that will maximise opportunities for the country's entrepreneurs to access the finance they require. The Company is cognisant of these expectations and is positioning itself to explore creative options, such as exploring the viability of entering the retail financing market on its own accord.

The challenge will be to achieve a balance in its efforts. Khula not only needs to assist SMEs to build sustainable businesses through financing, but must also provide solid business support interventions to bolster the sustainability of the SMEs funded. In addition, it will also have to extend the boundaries of its collaboration with the private sector and identify additional commercial partners who can assist in the future creation of business opportunities and providing additional and effective conduits for financing.

Chairperson's Statement

During its first decade as a wholesale financier, Khula devoted considerable time and resources to initiating and developing relationships with commercial partners, thereby maximising access to finance.

Private sector commitment is critical to the success of SME initiatives and creating additional access to finance and opportunities. In its next ten years, the company will concentrate on deepening its understanding of the developmental impact of its work. It will also strengthen its relationship with major financial institutions, commercial entities and public sector channel partners.

Acknowledgements

I congratulate the Managing Director - Xola Sithole, his management team and staff on their efforts in yet another very triumphant year in which substantial progress was made in ensuring Khula success in the small and medium business sector.

I also acknowledge with gratitude the commitment and sense of direction provided by the Minister of Trade and Industry and his team – your leadership has proven to be invaluable.

The strategic guidance provided by the Board and its various structures ensured the relevance and responsiveness of Khula. I wish to thank the members of the Board and its Committees for their continued commitment to the company and their excellent execution of their duties. Mr Xolile Ncame and Mr Mojalela Mohoto have in the period resigned from the Board. I would like to thank them for their contribution. I look forward to another successful financial year.

Nomonde Mapetla
Chairperson

Managing Director's Review

Xola Sithole
Managing Director

The 2007 financial year was a watershed year for Khula Enterprise Finance Ltd, a year when the benefits of a medium-term comprehensive strategic planning and organisational redevelopment process, commenced in 2004, began to be realised.

The positive changes within the organisation were also expressed through the achievement of the following milestones:

- The release of R746 million in funds for the development of the SME sector in the form of business approvals (2006: R462 million),
- For the first time in the history of the organisation, approvals to retail financial intermediaries (R298 million in 2007 compared to R63 million in 2006) exceeded those made via banks through the credit indemnity product (R266 million in 2007 when compared with R230 million in 2006). This fundamental shift in product mix is significant as it represents a shift towards a more direct investment approach in SME funding as opposed to favouring the leverage effects of the credit indemnity product.
- The signing of the revised indemnity agreement with the commercial banks. The agreement signals a significant turning point as it, for the first time, places high emphasis on developmental imperatives. Key amongst these is the increased regional focus in favour of more rural and peri-urban entrepreneurs together with a deliberate attempt to increase the lending patterns on loan sizes under R250 000.

The approval of a R100 million reverse factoring facility which is aimed at addressing the cash flow gap that is currently experienced by SMEs that have been awarded contracts by public and private sector entities. In a reverse factoring arrangement the selected accounts payable of a single buyer are discounted with the factoring house. Funds are advanced to SME suppliers based on the credit worthiness of the buyer, who makes direct payment to the factoring house. This arrangement will have a positive spin off for SMEs, as it will allow entrepreneurs to access much needed working capital, thus reducing the time gap between the delivery of goods or services and receipt of payment.

- Khula continued on a path of managed growth, showing significant improvements in both the size and quality of its book. Provisions for doubtful debts in 2007 amounted to 7% of the business loan book, down substantially from the peak levels of 38% in 2003.

A strong financial performance

One of the primary indicators of the positive change was an increase in the Group's net profit for the year which grew by 41% to R31 million (2006: R22 million), This increase in net profit was a result of increased revenue earned on business loans and financing activities. Revenues derived from investments and significant growth in the fair values of investment properties also contributed to the improved financial picture.

Khula benefited from the current environment that is characterised by rising interest rates. These increases which moved the prime lending rates up three full percentage points, helped Khula's investment income rise bys 16.5% over the previous year. The result was an average monthly effective interest rate earned during the year of 7,4% compared to 6.6% in 2006. It is Khula's long- term strategic objective to manage its exposure to interest rate changes more effectively, so that it can build a balanced portfolio.

An 18.9% growth was experienced in interest revenue from lending operations, which is attributable to increased loan business and book growth of 16.4%. Growth of 18.3% in the indemnity book yielded an increase of 13.5% in indemnity fees. The Group's total loan and equity book registered an increase of 30.3%, while potential commitments in respect of the core business activities that will need to be funded from cash resources totalled R466.8 million at year end.

Khula's property portfolio yielded a return on investment of 16% compared to 10% in the previous year. Khula is confident that the performance can be further improved as the return is diluted by a large number of properties (36%) that present an opportunity for development or outright sale. The property portfolio is also used for developmental purposes to empower local communities and entrepreneurs, contributing to local economic development and broad based black economic empowerment (BBBEE).

Non-interest returns on investments such as dividends reflected an increase of 13.5%. When compared to the significant increase in fair value gains of 162% which was R24 million in 2006. This contrasted strongly with a decrease of 18.5% in the value of non-core investments, as a result of the sale of approximately 50% of a listed investment, through participation in a BBBEE transaction, to the value of R36 million and realising a R3.3 million profit. The fair value increase can be attributed to the appreciation in value of the investment property portfolio, listed shares and an investment in the Anglo Khula Mining Fund.

Enhanced market penetration

Increased role clarity within the business has been accompanied by a change in product lending patterns. In 2003 approximately 70% of all Khula funds were distributed through commercial banks via the Khula Credit Indemnity product. In 2007 the level dropped below 50%. Central to this development was the introduction of new channel partnerships that are aimed at ensuring that our funding reaches a wider target market.

The funds freed up by this operational change have been used effectively, amongst other initiatives, to increase wholesale funding to non-banking Retail Financial Intermediaries (RFIs) who received approximately R300 million in 2007, a three-fold increase over 2003 levels of less than R100 million.

Critical to the selection of partners has been the infrastructure they could provide so that SME's and entrepreneurs across the country could be assisted. In this manner, people active in multiple sectors of the economy in the more rural regions have been reached.

The final step in the process was forming effective joint venture partnerships with selected corporate institutions to serve SMEs who benefit from the market opportunities created by these institutions.

KhulaDirect – the ultimate corporate positioning

The natural outcome of the process of working to become closer to our ultimate market, is to create a channel for entrepreneurs to directly approach the company. This would involve expansion of the capabilities of existing regional offices and where necessary the creation of additional infrastructure to meet increasing market demand.

This move would expose Khula to the entire spectrum of SMEs. Meeting these needs would require further development of the Khula suite of products and care that existing products are not "cannibalised" and therefore made less effective.

The KhulaDirect option is therefore currently being investigated. It will be subject to intense research and the development of a business plan, which will then be presented to the Department of Trade and Industry and the Cabinet for approval before commercial retail plans can be undertaken.

Khula plans for 2007/08

During the 2007/08 financial year Khula will continue to focus on the following strategic initiatives:

- Growing the value of approvals and disbursements to its SME financing partners by introducing new products and channels and by growing the level of business it does within existing sustainable partnerships;
- Ensuring that the funds provided are distributed to as wide a group of entrepreneurs as possible by choosing partners with the infrastructure to reach SMEs located in various parts of the country and active in multiple sectors of the economy;
- Growing and diversifying the property portfolio to increase the income yield, while ensuring that Khula continues supporting SME tenants to acquire some of the properties to build their capital base;
- Maintaining financial sustainability and improving process efficiencies while growing Khula's SME financing activity.
- Raising further funds from the shareholder to recapitalise the Khula balance sheet in order to finance the projected growth trajectory and sustain the momentum achieved so far.
- Reviewing the wholesale finance model currently in place with a view to obtaining shareholder approval for Khula to lend directly to SMEs in selected market segments.
- Increasing awareness of Khula and its products within its target market and achieving high client satisfaction levels.

Conclusion

There is no doubt that nationally, as is the case in many developing countries, the SME sector holds the key to closing the gap between the first and second economies that exists side-by-side in South Africa.

The critical challenge lies in addressing the mismatch between the needs of SMEs on the one side and commercial sector offerings on the other. SMEs primary needs are for risk capital or equity for start-up entreprises and development of business in the early stages. The commercial sector's offering concentrates on debt on the back of a Khula guarantee.

Khula will therefore continue in its role as a bridge across this divide and its strategic emphasis on effective channel partnerships, promotion of joint ventures and effective utilisation of resources to assist it in fully participating in creating opportunities.

I am confident, however, of our ability to meet these and other challenges. We will continue to "fine-tune" our strategic approach to our markets as changing circumstances dictate.

Acknowledgements

Our accomplishments in the 2007 financial year have been due to a willingness of staff at Khula to embrace the challenges presented through our change in direction and new emphasis on active partnerships with our channels. My thanks go to you all for the support that the executive management team and I have enjoyed.

I also acknowledge the role of the honourable Minister Mandisi Mpahlwa and Deputy Minister, Elizabeth Thabethe, of the Department of Trade and Industry, our Chairperson Nomonde Mapetla and members of the Board who have willingly given of their abilities and talents. Your counsel, observations and assistance have been of great assistance and are appreciated.

The executive management team at Khula have given of themselves unstintingly during a period that has had its difficulties and operational obstacles. Your support has ensured our success – my thanks as well.

Finally, I thank our channel partners who worked together with us to achieve outstanding results for the entrepreneurs of South Africa.

I look forward to your continued support and a fulfilling 2008.

Xola Sithole
Managing Director

Eunice Civil Construction

Cynthia Kwinika

Eunice Civil Construction at work

Eunice Civil Construction

When Cynthia Kwinika battled to find a job, she decided to venture into housing construction - a field which a few courageous women take to. Through a series of government workshops and short courses in construction, she worked on getting government contracts to build low-cost houses and hostels, in Gauteng, specifically in Pretoria and Johannesburg. In the last year Cynthia has built more than 120 RDP houses in Soshanguve, outside Pretoria. She employs six permanent staff. After struggling with late payments for her invoices by the government department which commissioned her to build houses, Cynthia applied for a bank loan. The bank advised her to apply for Khula Credit Indemnity Scheme as she did not have enough collateral to cover the needed loan. Khula was able to assist Cynthia. When her loan was paid to her she was able to pay her employees and buy more building materials while waiting for her invoices to be paid.

Success Story

The Eunice Civil Construction Team

Operations Division Review

The overriding objectives of the Operations Division are to maximise access to finance for the SME sector through effective management of relationships with channel partners, the development of new products and growth of the distribution network to ensure that the maximum development impact is achieved through the Company's activities.

The 2007 financial year was noteworthy in several respects. Core business approvals rose significantly to record levels reaching R746 million (2006: R462 million) an increase of more than 60 % over the previous year.

Disbursements grew however flat at R343 million (2006: R329 million), representing a marginal increase of 4%. This is largely as a result of some of the larger transactions that were concluded towards the end of the financial year. It is thus anticipated that disbursements for 2008 will reach record levels since the organisation was established in 1996.

Reaching the market

Financial Institutions Channel

The Financial Institutions Channel delivers its products and services through banks and non-banking financial institutions active in the SME market, namely Retail Financial Intermediaries (RFIs). The channel is focused on identifying and partnering with sustainable financial institutions that have the expertise and capacity to deliver Khula products to our target market.

Steady performance of the Credit Indemnity Product

Business approvals for the year under review grew by 16% from R230 million in 2006 to R266 million. Disbursements were up by 11% to R243 million (2006: R218 million).

There are still challenges with respect to the beneficiaries of the scheme in terms of gender, racial and geographic distribution. We are hopeful that once the new agreement with the banks is concluded it will go a long way in addressing these anomalies.

Records approvals through Retail Financial Intermediaries (RFIs)

Khula provides wholesale finance to RFIs for on-lending to entrepreneurs. Our strategy of supporting and strengthening commercially sustainable RFIs that can deliver on our mandate is starting to bear fruit. Increased activity and identification of new RFI partnerships saw approvals reach a record of R298 million (2006: R63 million). It is also

the first time in the history of the organisation that approvals to RFIs exceeded those via banks through the credit indemnity product.

Disbursements were however down from R84 million in 2006 to R63 million in 2007. This is mainly due to approvals of the larger transactions towards the end of the financial year - 94% of the beneficiaries were black and 55% were women.

Increased emphasis on the RFI's operating outside the ambit of the banks, has meant that a larger spread of SME's in the provinces have been reached. Strategic investments by Khula in certain RFIs have enabled Khula to also influence their financing patterns.

Public Sector Channel

The Public Sector Channel seeks to facilitate access to finance for SMEs that operate in the public sector by partnering and managing funds earmarked for SMEs on behalf of government departments and state owned enterprises.

New partnership with Department of Agriculture to assist emerging farmers

In order to enhance access to finance for emerging farmers, Khula has approved a R75 million Portfolio Indemnity with the Department of Agriculture's Micro Agricultural Financial Institution of South Africa (MAFISA) for planting inputs.

Performance of the Land Reform Empowerment Facility

The Channel currently manages the Land Empowerment Facility (LREF) on behalf of the Department of Land Affairs (DLA), the Department of Environmental Affairs and Tourism (DEAT) and the European Union. The LREF exceeded its loans approval target in the Eastern Cape Province by 3.1%. The Channel attributes this growth to the market's increasing appetite for the LREF concept.

Eleven new projects valued at R33 million were concluded for the year under review bringing the LREF portfolio size to R178 million.

MMG Enterprise

MMG Enterprise at work

Mpho Gura

MMG Enterprise

Mpho is another successful recipient of a Khula Credit Indemnity Scheme. She has run a successful business in Mafikeng making school tracksuits, uniforms, wind breakers and other items of a similar nature. Mpho initially worked as a teacher before starting a small business in her garage. Her major clients were parents of school children mainly from the school where she had worked, as well as ex-colleagues. As the business grew, she needed working capital and finance to buy additional equipment. The Enterprise Support Centre in Mafikeng advised her to apply for a bank loan through a Khula Credit Indemnity Scheme. Although Mpho has struggled with ill-health her fighting spirit as kept her business going.

Success Story

The MMG Enterprise Team

Corporate Channel

Effective partnerships: leveraging results

The purpose of the Corporate Channel is to establish joint venture partnerships with selected corporate institutions for the financing of SMEs which benefit from market opportunities created by these institutions. This unit also makes investments in large externally managed funds which are dedicated to the financing of SMEs that operate within Khula's target market.

During 2007, Khula concluded two key partnerships:

Khula Enablis SME Acceleration Fund

This is a partnership between Khula and Enablis. This Fund is currently capitalized at R50 million (Khula R40 million and Enablis R10 million) with an intention of attracting new investors to recapitalise the Fund at R100 million.

The focus of the Fund is to provide both financial and non-financial support to SMEs in the following sectors:

- Agribusiness
- ICT
- Transportation
- General Services

DaimlerChrsyler Portfolio Credit Indemnity

This is a partnership between Daimler Chrysler Financial Services (DCFS) and Khula. The purpose of the portfolio is to enable DCFS to finance and mentor emerging black SMEs in the trucking industry. The facility is capitalized at R100million with Khula providing a 30% portfolio indemnity.

Existing Partnerships

a) Anglo-Khula Mining Fund

This is an equal partnership between Khula and Anglo American which provides financial and non-financial support to black empowered and viable SMEs involved in small scale mining. The support ranges from R1 million to R5 million. During the year ending March 2007, the Fund approved investment proposals totaling R14 million (2006: R12.4 million). Disbursements increased to R5 million (2006: R3.4 million).

b) Enablis Khula Loan Fund

This is a R50 million partnership between Khula (R20 million), Enablis (R25 million) and First National Bank (R5 million). The Fund facilitates loans ranging from R100.000 to R2.5 million to ICT focused SMEs through the provision of indemnities to FNB. In 2007, the Fund approved 7 investment proposals from black owned companies totaling R9.8 million (2006: R10.6 million).

c) Khula Shoprite Joint Venture

The Khula Shoprite Joint Venture is a R40 million partnership, managed by Shoprite and aimed at facilitating ownership of OK Foods Franchises by black entrepreneurs. The joint venture provides loan capital to prospective entrepreneurs to establish and manage OK Foods Franchises. The take up on this facility has been very slow and Khula is reviewing the partnership.

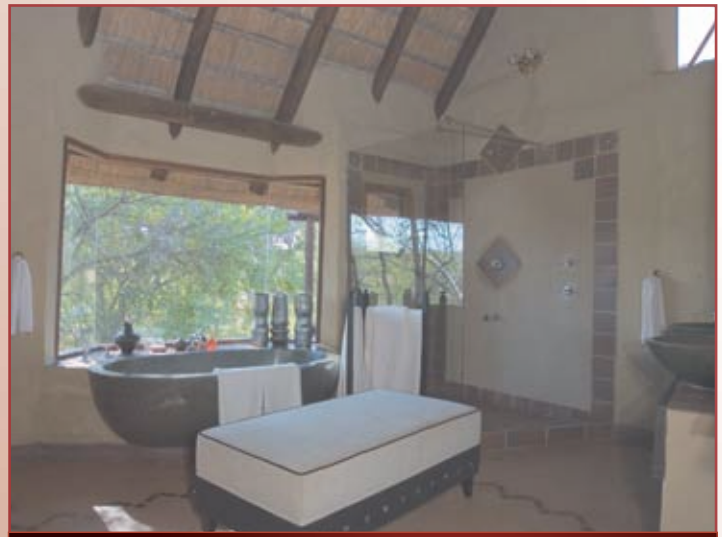
d) Business Partners Khula Start-up Fund

The Fund is capitalised at R150 million of which Khula contributed R120 millon and Business Partners R30 million. The Fund is exclusively targeted at Black entrepreneurs requiring start-up capital. Approvals and disbursements for 2007 were R25 million and R18 million respectively. This is notable achievement as the Fund is only a year old.

e) Fundisa Portfolio Credit Indemnity

Fundisa is an R15 million portfolio credit indemnity established in February 2006 by Khula and Fundisa Communications (Pty) Ltd. Khula provides indemnity on behalf of rural shop owners who acquire community pay phones. The take up on the facility is lower than anticipated with only about R447 484 indemnities approved in the first year.

Lukimbi Safari Lodge



Lukimbi Safari Lodge

Human Resources Manager/Director/Shareholder at the Lukimbi Safari Lodge
Alfred Mabunda

Lukimbi Safari Lodge

The Land Reform Empowerment Facility (LREF), managed by Khula, facilitated a transaction where an Empowerment Trust was set up to own the majority shareholding of Indulo Property (Pty) Ltd, the shares of which were purchased through a grant from DEAT. Workers at the Lukimbi Lodge and its sister lodge, Idube, acquired a 74% stake in Indulo Property (Pty) Ltd. The assets of the property company, which are some of the buildings of Lukimbi, are leased to Lukimbi Safari Lodge, thus generating income for the Property Company, which in turn pays dividends to the Trust. The Trust makes annual payments to all shareholders. Indulo was the first Khula LREF project based on the disbursement of the LREF's Community Empowerment Facility equity grants, which have been used to capitalise the shareholding of the workers in the partnership. This safari lodge has been running for five years and it is growing from strength to strength.

Success Story

Lukimbi Safari Lodge located within the Kruger National Park

Customer Support Services

Ensuring the long-term sustainability of the supported SMEs

Khula provides mentorship and other value-added services through the Khula regional offices and independent mentorship service providers whose role is to ensure the long-term sustainability of the supported SMEs.

Business loans approved with the assistance of mentorship services exceeded expectation with R108 million approved against 2006 approvals of R96 million, representing an increase of 13%.

Innovation in Finance

Khula constantly monitors the market to ensure that its services and products keep pace with the developing and changing South African SME market. One of the major challenges for any small business is maintaining a positive cash flow. Many SMEs face the risk of failure when their invoices to larger customers are not settled on time.

Traditionally, SMEs have not had access to corporate services such as Factoring - a process whereby a financial institution "buys" a company's invoices at a discount and then makes a profit by collecting the full sum of the debt from the customer. This product is mainly accessible to established companies that generally have large receivables from multiple sources to provide a Factoring House, making the deal attractive to both parties.

In the South African SME sector, Regent Factors pioneered the introduction of a reverse factoring service and Khula has acquired an equity stake in Regent Factors. "Reverse Factoring" has become an indispensable tool to many small businesses in international markets servicing the corporate sector. In reverse factoring the lender purchases accounts receivables only for high-quality buyers. The main advantage is that the credit risk is equal to the default risk of the high-quality customer, and not the SME.

This arrangement is beneficial for SMEs as comprehensive credit information on all the borrower's customers is not required. Secondly, reverse factoring allows SMEs to transfer their credit risk and borrow on the credit risk of creditworthy customers. This may allow firms to borrow greater amounts at lower costs.

Outlook

The conclusion of the Revised Credit Indemnity Agreements with major retail banks will enable Khula to set performance targets that will enable the Credit Indemnity Product to be accessible to more targeted entrepreneurs at affordable rates. The revised agreement signals a significant turning point in the financing of SMEs as it places high emphasis on developmental imperatives, such as increased regional focus in favour of more rural and peri-urban entrepreneurs, promotion of gender and racial equity as well as funding of start-up businesses.

The opening of a direct lending channel would enable Khula to play a significant role in broadening the reach of Khula further and enable the company to further close the gaps existing in the provision of SME finance. The KhulaDirect business case has been completed and will be presented to the dti for approval.

Khula sees the current increases in base interest rates having a dampening effect on demand for SME finance and possible increased defaults only if the prime lending rate rises significantly and swiftly several points above 14%.

Robust demand for finance from the SME sector, which has been accompanied by increasing use of their services by corporations and awarding of government tenders, is expected to continue. This can be expected to last until at least 2010 as the country gears up with infrastructure and other developments for the Soccer World Cup.

Present indications are that job creation is increasing and this positive trend is also expected to continue.

Siyaya Ubuntu Trading Enterprise

Mohamed Ally

Siyaya at work

Siyaya Ubuntu Trading Enterprise

Mohamed saw a business opportunity in the brick and block market in the Pietermaritzburg area and decided to start his own block yard. He found suitable premises near his target market in Royston Road. He applied for a loan through the Business Partners-Khula Start-Up Fund to purchase the equipment he needed to start his business. The plant has been running since February 2007 and is trading well. There are two production lines at this plant with 16 permanent employees, three of whom are women. Mohamed's customers are from Pietermaritzburg and surrounding areas. So far there has been no formal makerting for Siyaya, Mahomed gets his customers mainly through word of mouth.

Success Story

The Siyaya Team

Risk and Compliance Division

Risk - a cost of doing business

During their everyday operations all companies expose themselves to risk. Risk within Khula is mainly associated with its role as a provider of development finance and the multiple intermediary channels it uses to achieve its mission of being a leading provider of wholesale finance to the SME sector. The function of the Risk and Compliance Division is to reduce and manage this risk within acceptable limits.

To this end the Division constantly monitors external and internal developments affecting the Company. Recommendations are then made on the introduction of strategic management interventions and systems necessary to control the Company's risk exposure and ensure that the financial sustainability of Khula is maintained.

The process includes examining all operational expenditure that is undertaken and its alignment within budgets, ensuring that budgets are realistic and that service providers distributing wholesale funds from Khula to the market are undertaking their responsibilities effectively.

Effective risk management

Effective risk management is focused on minimising losses. Appropriate steps within the company are taken in conjunction with the Board's Audit and Risk Committee, internal and external audit and executive management as required. Strategic and operational risks are identified and action plans to mitigate them are monitored. Measures introduced have included a fraud hotline, operated by an independent company, for anonymous reporting of fraudulent activities.

An "in-house" credit committee (named Thebe) reviews all aspects of credit management, ensuring cooperation across all operational units so that proactive measures can be taken if deterioration is experienced in the payment patterns of Retail Financial Intermediaries.

As part of the process, all new Khula clients are subjected to due diligence exercises. Existing clients are reviewed as circumstances require.

Improvement in quality of debt

The success of these and other activities have resulted in a significantly improved debtors' book. A changed focus on supplying funding via self-sustaining Retail Financial Intermediaries, has also yielded positive results for the Company.

Risk and Compliance Division

During the year under review, the focus of the Division lay on ensuring Khula's compliance with changing legislation including the introduction of the National Credit Act. The Division was initially involved, as an interest group, providing input on the legislation. This included assessing the impact of the legislation on Khula and users of wholesale finance in the SME sector.

The impact of the National Credit Act on Khula is limited, as many of Khula's channels fall outside the scope of the legislation. Khula is not impacted on as interest rates charged are within the limits of the Act, and Khula's RFIs fall outside the scope of the Act.

The development of a "risk control framework" was undertaken and rolled out across the company with appropriate training. Training covered all facets of the relevant legislation affecting Khula's operations and included Khula's Head Office, regional offices, Retail Finance Intermediaries, mentors concerned with financial education and other stakeholders.

Changes in internal audit

Khula's internal audit function is currently outsourced. As the company's strategic role has changed, so this aspect of operations has come under review. An Internal Audit Division is being created within the company that will initially focus on certain areas of the operations. The internal audit function will then be enlarged as required and consideration will be given to bring the full internal audit function in-house.

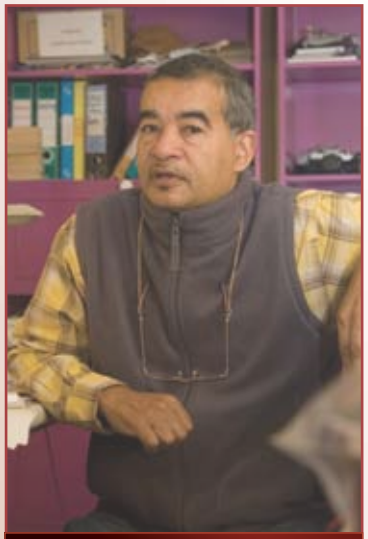
Policies, procedures, systems and controls

An integral part of risk management is the development of policies, procedures and systems that are subject to effective controls.

Within this area of activities the Division has worked hard to ensure that all advisory services comply with the regulatory and legislative frameworks applicable to the company. Through the legal advisor, Khula negotiators are kept up to date with changes in legislation and provided with appropriate legal advice as well as assistance with the drafting and vetting of key documentation.

Compliance with company policy, legal requirements and corporate governance are enforced through building cooperative partnerships with divisions assisting and advising them as required. At all times, however, the independence of the Risk and Compliance Division is maintained.

Industrial Hive - Mitchell's Plain



Kenny Brinkhuis

A cupboard making business at the Alpha Industrial Hive

Industrial Hive - Mitchell's Plain

The Khula Property Division sold various properties in the last year. Among these were the Mitchell's Plain based Alpha and Bravo Hive properties which were sold to the majority of the tenants. Featured in the photographs are: Kenny Brinkhuis, business owner / member of the Body Corporate at the Industrial Hive, and two successful businesses based at the Alpha Hive.

An engineering business also situated at the Alpha Industrial Hive

Property Division

Khula owns a investment property portfolio which at 31 March 2007 was valued at R151.5 million and consisted of 58 properties with a total lettable space of 205,882m². The management and administration of the property portfolio is outsourced to Business Partners Limited. Capital improvements affected during the period amounted to R500 000. During the year various properties were sold for R12.5 million and 79% of the purchasers were by previously disadvantaged individuals. Another 11 properties were also approved for sale. Khula sold its Alpha and Bravo Hive properties in Mitchell's Plain and the Blackheath Hive property in terms of a sectional title deed scheme to the majority of its tenants. At year-end 43% of the units had been transferred to the tenants.

Khula's overall strategic objective is to earn reasonable returns that will facilitate financial sustainability. Properties are among other criteria classified on the basis of their ability to earn income and ability to contribute to SME empowerment and development. It is the intention where properties do not meet the pre-determined criteria that they will be sold off during the next two years. Proceeds from the sales, as far as possible at market related prices, will be used for recapitalisation purposes and potential investment in property related SME development and empowerment projects. The remainder of the portfolio will be utilised to support Khula's strategic plan for providing financial sustainability and simultaneously satisfying Government's mandate of SME empowerment and development.

When disposing of properties that do not conform to Khula's strategy, preference will continue to be given to tenants, local communities and businesses drawn from the historically disadvantaged sector of the population. BEE principles are also applied as part of the procurement processes related to the portfolio and 63% of the 2006/7 procurement was by BEE suppliers.

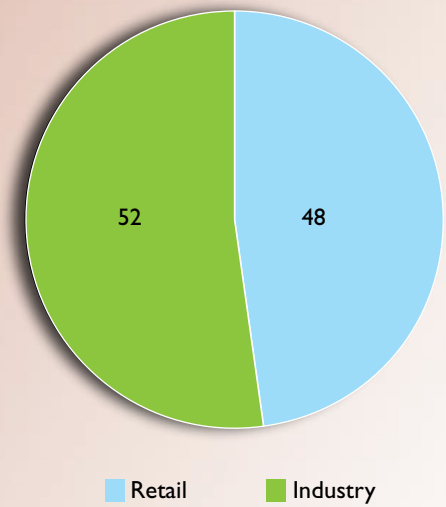
The Khula Installment Sale Agreement ("ISA") scheme is available to assist existing tenants acquire a property from Khula. This occurs, however, only when all other avenues of financing have been exhausted. Since the introduction of the scheme 11 ISA sales to the value of R22.3 million have been approved.

More focus will also be placed in the next financial year on identifying properties and projects in the current portfolio as well as through normal business ventures that can be developed in synergy with Khula's overall business strategy and that will assist in the promotion of economic development of SMEs in various communities.

Compared to the average national property market yields over the past four years, Khula's portfolio's performance of 16% returns are on par with the market. The period under review showed a significant improvement up 10% over 2006. Returns can be increased further as some of the remaining properties earmarked for immediate sale are mostly loss-making properties which distorts the higher returns yielded by the good properties. However, it must be borne in mind that Khula's property portfolio is also utilized for developmental purposes of both local communities and entrepreneurs. This prevents Khula from, in some instances, levying market-related rentals to maximize returns.

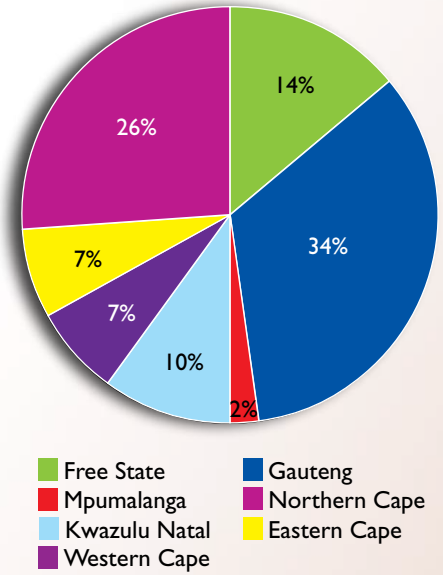
Property Division

Sectoral Breakdown of Portfolio



The portfolio represents the full spectrum of commercial and specialised properties that are situated in most of the country's major commercial centres. There are currently 1,270 businesses accommodated in the premises. Drawn from all sectors of the economy, the majority are industrial and retail businesses. Only 5% of the businesses occupying the premises have national representation. The remaining 95% is occupied by entrepreneurs, of whom 86% are black and 20% women.

Geographical Distribution of Portfolio



Statistics indicate that about 6,308 job opportunities have been created and that 84% of these involve full time employment and 37% female employment. Collectively, these businesses employ a large number of people and, as such, represent an important contribution to economic stability and success in the country.

The industrial portfolio comprises of hives (a building divided into small units and let to informal entrepreneurs for 'start-up' businesses); factories (free-standing units ranging from small to large) and industrial parks. The retail portfolio comprises shopping centres.

Human Resources

Overview

As an integral part of Khula's strategic direction in the year under review, the Human Resources Department focused on the following strategic objectives:

- To be cost-effective, placing high-value on swift delivery of services at the lowest cost;
- Employing leading edge human capital;
- Renewed focus on our performance management system;
- Creation of an appropriate learning and sharing culture environment; and
- Continuing to focus on ensuring that there is a healthy and conducive working environment for all employees.

People Management

The most important aspect of talent management for Khula is to recruit the right person with the right fit for each position. Thereafter focus on ensuring the effectiveness of the skills acquired and the continued development and retention thereof. Our strategy is designed to encourage continuous learning, professional growth and career development. Our practices are driven towards valuing, appreciating and nurturing talent. Appropriate remuneration, recognition, development and delegated authority are regarded as critical focus areas for our deliverables to ensure staff satisfaction. We believe that satisfied and motivated staff assists Khula in delivering quality services and in executing its mandate. The result of Khula's efforts and initiatives to retain its staff is evidenced through a significantly reduced staff turnover to 7% during the year under review and succeeding in the retention of all the members of its senior and middle management team.

Training and Development

Continual development and enhancement of the skills of the workforce are one of Khula's core objectives. Training initiatives and programmes are designed (packaged and custom-developed) and planned according to the strategic skill priorities identified. They take into consideration the specific needs and required competencies of each employee. Personal development plans are designed for each employee on an annual basis.

Human Resources

In line with our objectives and commitment to invest in our people and to develop them, various initiatives and training interventions were undertaken during the year. The company achieved 159% (402 interventions) of its planned interventions during the year with specific focus on areas such as: customer interface; management and leadership skills; specialist financial skills; legislative compliance and personal development.

In addition to the training and development model, Khula's policy on study assistance enables employees to apply for financial assistance to support their continued learning needs. For the period thirty six (36) employees were offered bursaries to study various courses in line with Khula business objectives and strategy.

Khula is registered with Bankseta and is actively participating in the grant schemes as outlined in the Skills Development Act. All relevant submissions in terms of the legislation have been made.

Employment Equity

Khula views employment equity as a priority with the aim of having an integrated and diverse workforce that is representative of the South African population. Khula regards the creation of an equitable working environment, with the dignity of all employees respected and the diversity of employees valued and properly managed, as a solid base for longer-term growth and maintaining a competitive advantage. Our current staff profile is an indication of Khula's commitment to employment equity.

Khula's human resource principles reflect sensitivity to issues of gender equity. Great strides have been made towards gender equality. Women represent 72% of the workforce. During the year under review, of the four executive members, two (50%) were women. Similarly, at management level, out of 19 managers, 10 (53%) were women. This provides compelling evidence of Khula's commitment to empowering women. An age analysis of Khula's employees indicates that 70% have an average age of 39 and 36% have been employed for more than four years.

Staff Profile

The table below reflects the profile by gender, race and level as at 31 March 2007.

Occupational Level	Male				Female				Total
	A	C	I	W	A	C	I	W	
Executive	1	-	-	1	1	-	-	1	4
Senior Management	5	-	-	-	2	-	-	2	9
Middle Management	3	-	1	-	4	-	-	2	10
Professional	5	-	1	2	8	-	-	1	17
Senior & Support Staff	1	-	-	-	27	1	-	2	31
Total	15	-	2	3	42	1	-	8	71
	20				51				
	28%				72%				

A = African C = Coloured I = Indian W = White

Organisational Culture

Employers of choice are those companies that have the ability to outperform their competitors. They achieve this recognition through innovation and modern human resource practices that benefit both employers and employees. Therefore, people voluntarily invest in work. When trust is present, everything else is easier.

To create a strong Khula brand and a message that appeals to employees and top performers, we linked corporate values to excellence awards as an effort towards becoming an employer of choice, motivating/energizing staff and increase the effectiveness of strategy implementation through our people.

Khula remains committed to developing an organisational culture that is characterised by values, norms, beliefs, systems and practices that are inclusive and supportive of the development of all its employees. This is reflected in our excellence awards, which link the value system to the recognition and reward of desired behaviours.

Performance Management System and Reward

Khula's performance management system is underpinned by the principle that rewards are based on performance and value creation. The cornerstone of this strategy is an output-orientated system characterised by accountability for results. Employees are motivated to perform through participative target setting, empowerment and meaningful compensation and career development.

The performance management system objectively measures criteria that are consistent with the strategic objectives and values of the organisation, and produces results that are comparative with others in the Group on an equal performance level.

Performance targets are set in a cascading process using the Corporate Balanced Scorecard as a measuring tool for goal alignment and broadening of the organisational performance measures. Reviews are held on a regular basis with staff and final appraisals, together with 360 degree assessment techniques are used to determine annual salary reviews and incentive bonus payouts.

Lorraine Summits the Kilimanjaro

In September 2006, Lorraine Chemaly, Khula's Training Co-ordinator, made it to the top of Mount Kilimanjaro. The climb up took five days and four nights. When she reached the mountain top she flew the Khula flag high. Khula is very proud of Lorraine's achievement and would like to see more Khula staff attempting challenges of this nature.

Employee Wellness

Employee Assistance Programme (EAP)

In an effort to counteract potentially detrimental impact of personal and work-related stress on job performance, Khula partnered in 2004/5 with the Institute for Counselling and Advisory Services (ICAS) for Employee Assistance Programme (EAP), which provides support to employees and their families. The main aim of the EAP is to assist employees to be healthy, productive and creative contributors to their workplace and the community at large.

In addition, employees have access to a 24-hour, confidential and professional support service at ICAS, tailored to assist them in the management of day-to-day personal and work-related difficulties.

The EAP's role as a support mechanism to both individual staff members, and the organisation as a whole, has been evident from the high utilisation trends. Khula has estimated that there is a continuously high return on investment as a result of the high utilisation rate.

HIV/AIDS initiative

HIV/AIDS is an indiscriminate disease that affects everyone. Medical counselling and support is offered by ICAS and by Discovery Health to staff and their families who might be infected or affected by HIV/AIDS. Various HIV/AIDS initiatives were undertaken during the year to ensure continuous education and awareness amongst employees.

Thandi Wines

Portfolio Committee member, Mr Sisa Njikelana meets Paul Cluver jnr and Thandi Wines beneficiaries

A field visit of the apple farm by the Committees

Portfolio Commitee on Trade and Industry, and the Select Committee on Economic and Foreign Affairs on an oversight visit at Thandi Wines

The Portfolio Committee on Trade and Industry and the Select Committee on Economic and Foreign Affairs accompanied by the Khula Managing Director and other Khula members of staff, visited Thandi Wines in Grabouw in the Western Cape. The story of Thandi wines began in 1996 when the Cluver family made available 100 hectares of unfarmed land from their 2,000-hectare farm to the 147 people living in villages close to their farm. Khula assisted the community through the Land Reform Empowerment Facility, to acquire the land, and the South African Forestry Company, Safcol, also donated land. The project comprises 16 hectares of apples, 12 hectares of pears, 4 hectares of plums and 14 hectares of wine grapes. The intention is to plant a further 70 hectares of wine grapes consisting of Sauvignon Blanc, Cabernet Sauvignon and Merlot.

Wine-tasting session at Thandi Wines

Marketing and Corporate Affairs Division

The main function of Khula's Marketing and Corporate Affairs Division is to interpret the values and aspirations outlined in the company's mission and vision statements, and to build internal and external understanding and support for the Company, as it works towards its objective of enhancing the development of the South African SME sector.

This encompasses a process which needs to take account of the needs of diverse external audiences, which range from the emerging entrepreneur seeking finance, who needs to understand how Khula functions and what Khula offers, and extends to the Minister of the Department of Trade and Industry (to whom Khula reports), Parliament, channel partners, associates, the media and other interested parties.

Simultaneously, within the Company, the Division is responsible for creating and maintaining a communications environment within the head office and regional offices that enhances staff understanding and support of Khula's corporate aims.

Achieving the above communications objectives requires that the external and internal communications climates be constantly monitored. Appropriate interventions are then introduced as needed to achieve short, medium and long-term objectives to meet specific market expectations in what is a complex and demanding business environment.

Reaching out to the people

Khula participated in variety of activities and events with the aim of reaching as broad a spectrum of entrepreneurs as possible. To achieve broader exposure, Khula also made use of strategic exhibition opportunities, and participated in various provincial investment conferences, trade shows, small business expos and the dti related road-shows. These include, amongst others, "Taking the dti to the People" campaign; Annual Small Business Summit; Small Business Week; Franchise Association South African (FASA) exhibition; National African Federation of Chambers of Commerce (NAFCOC) conference; Annual Tourism Indaba and the Industrial Development Conference (IDC) investment conferences.

Radio campaign

As a follow up to the Enterprise Zone TV campaign flighted on the SABC in the last financial year, aimed at educating and informing entrepreneurs about Khula product offerings, a series of radio discussion programmes supported by Khula messages on SME matters was launched. The campaign, which lasted 13 weeks, flighted on five major SABC African language radio stations was well received by the public.

Media relations

Although we have had limited media presence in the year under review, the Division has co-ordinated media interviews for the Managing Director. These interviews include

media such as the Mail Guardian, Succeed Magazine, City Press, Sowetan, Business Day, Business Report, SABC 3's Business Hour, Summit TV and SAFM. The Unit continues to engage with members of the media through press releases and telephonic interviews, as issues arise.

Parliament and other stakeholders

During the year under review Khula strengthened its relationship with government, parliament and other stakeholders within the Department of Trade and Industry through various forums and presentations to ensure strategic alignment.

Corporate communications

To build and maintain strong communication channels some new internal interventions were launched, existing ones were strengthened and they continued to make a difference to staff during the year under review. The interventions include the following:

The MD's Imbizo – the MD addressed staff throughout the year at five of the Imbizo gatherings, informing and updating staff on the state of the organisations. At such a gathering staff are encouraged to interact with senior members of management on an informal basis. This is meant to minimise the communications gap between different levels that exist within the Company. The Imbizos continue to be well supported by staff.

Stimela Mail Newsletter – the internal newsletter was launched towards the end of the year under review and this was very well received by Khula staff. The main purpose of the newsletter is to inform, educate and entertain. It also elaborates on matters communicated briefly in the electronic Stimela Mail – which is mainly used as an urgent announcement tool. The electronic Stimela mail continues to channel announcements to the staff.

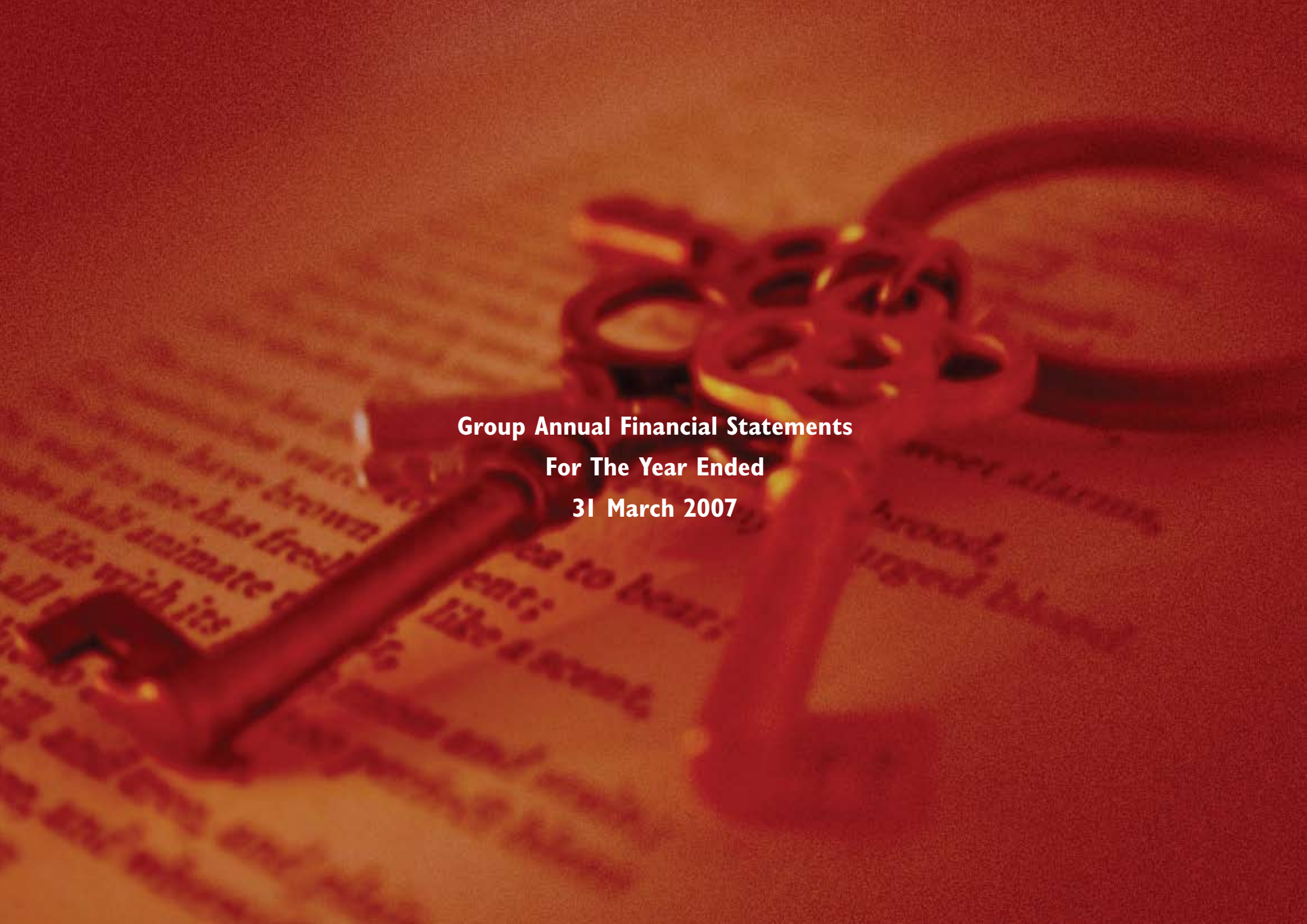
Brand awareness

As part of monitoring the environment within which Khula operates, the Marketing Division commissioned an extensive research to determine Khula's brand positioning in the SME market. The findings of the audit will be available in the next financial year. They will be used to enhance the Company's relationships with its partners and product offerings and to introduce improvements and changes where they are required.

Steps to improve customer satisfaction levels

The importance of the Contact Centre as the "face of Khula" will be re-evaluated and steps to ensure that it becomes more "customer-centric" will be taken. During the 2006/7 financial year, an annual client perception survey was introduced to measure client satisfaction levels on an ongoing basis.

An overall objective of these initiatives is to bring Khula closer to its client.



Group Annual Financial Statements
For The Year Ended
31 March 2007

Khula Enterprise Finance Limited

Registration No 1995/011258/06

(Incorporated in the Republic of South Africa)

Group Annual Financial Statements
For The Year Ended

31 March 2007

Contents

Introduction

Khula Enterprise Finance Limited (Khula) is a development finance institution established in 1996 under the Companies Act as a Department of Trade and Industry initiative. Khula is an independent, limited liability company, with its own Board of Directors.

The objectives and mandate of Khula, the powers of our Board of Directors, as well as the relationship between Khula and our shareholder, are set out in the Companies Act and its regulations, the memorandum and articles of association of the company as well as the Shareholders Compact agreed annually with the shareholder. Khula is also subject to the provisions of the Public Finance Management Act No 1 of 1999, as amended, (the PFMA) and Treasury Regulations which deals with best practice in financial management, focusing mainly on outputs and responsibilities.

The South African Government, through the Department of Trade and Industry, is the sole shareholder of Khula.

The Board of Directors of Khula is responsible for the corporate governance of the company. The Board guides and monitors the business and affairs of Khula on behalf of its shareholder, by whom they are elected and to whom they are accountable. Khula subscribes to the principles set out in the King II Report on Corporate Governance (King II) and the Protocol on Corporate Governance in the Public Sector and in this regard, we are constantly reviewing our systems and procedures in an endeavour to adhere to these principles as closely as possible. Khula confirms its commitment to the principles of openness, integrity and accountability as advocated in King II. Through this process, the shareholder and other stakeholders may derive assurance that the group is being ethically managed according to prudently determined risk parameters in compliance with generally accepted corporate practices. Monitoring compliance with Corporate Governance practices and principles as well as the PFMA forms part of the mandate of the Audit & Risk Committee.

Board Composition

The appointment of the Board of Directors of Khula is conducted by the shareholder. The Board comprises fourteen directors, thirteen of whom are non-executive directors, including the Chairperson, the deputy-Chairperson and one being the executive Managing Director.

Directors' appointments are based on their ability to contribute the appropriate skills and time required to assist the group in its operations and future development. The adequacy of the Board and the appointment of new directors are reviewed periodically by the shareholder.

Directors' terms of appointment are governed by the company's constitution and are subject to periodic re-election and shareholder approval.

The Board operates within a unitary structure that provides for interaction among all board members in the decision-making process on strategy, planning, performance, allocation of resources, business ethics and communication to stakeholders.

The Board meets regularly, on a quarterly basis, and executive management attends board meetings by invitation only. The Board monitors management, ensuring that material matters are subject to Board approval.

The roles of chairperson and managing director do not vest in the same persons and the chairperson is a non-executive director. They provide leadership and guidance to the Board and encourage proper deliberation on all matters requiring the Board's attention, and obtain maximum input from the other directors.

Roles and Responsibilities of Directors

The Board has ultimate responsibility for the oversight, management and strategic direction of the group. Accountability to the shareholder remains paramount in Board decisions, and this is balanced against the demands of the regulatory environment in which the group operates, and the concerns of its stakeholders.

In compliance with section 56 of the PFMA, the Board has adopted a comprehensive delegation framework aimed at clarifying the various limits of authority in place within Khula. Through the framework, the Board has sought to clarify and ensure effective control of Khula. To this effect the Board has defined levels of materiality and has reserved specific powers to itself while having delegated other matters to management. Responsibility for the formulation of strategy and day to day operations and administration is delegated by the Board to the Managing Director, assisted by the Executive Management Committee. Other functions of the Board include:

- Approving goals, strategies and plans for the group's direction, formulated by management, as well as monitoring implementation;
- Discussing and approving management recommendations;
- Monitoring the group's performance and results; and
- Meeting statutory, regulatory and reporting requirements in terms of the Companies Act, the PFMA and other relevant legislation.

Each director has the right to seek independent professional advice at the group's cost, subject to the approval of the Chairperson.

To assist the Board in discharging its collective responsibility for corporate governance, several Board Committees have been established, to which certain of the Board's responsibilities have been delegated. These Committees operate with written terms of reference and comprise, in the main, non-executive directors. The chairperson of each committee is a non-executive director.

Board Committees

Investment Committee	Human Resources Management & Remuneration Committee
N Greenhill (Chairperson)	NT Mapetla (Chairperson)
N Lala-Mohan	YG Benn
GMB Mokoena	N Lala - Mohan
ML Mkhize	NC Msizi
XGS Sithole	XGS Sithole
M Zungu	DMN Thabaneng
M Ferreira *	B Ngubane* [Appointed 30 May 2006]

Audit & Risk Committee	Executive Committee (EXCO)
IAS Tayob (Chairperson)	XGS Sithole (Chairperson)
M Mashiya	G Kekana
ML Mkhize	T Mc Donald
X Ncame – [Resigned 26 February 2007]	D de Jager
	Z Nomafu [Appointed 1 May 2007]
	N Ntsinde [Resigned 30 November 2006]

* *Independent co-opted member*

Audit & Risk Committee

The Audit & Risk Committee consists of three non-executive directors and may elect at least two independent non-executive co-opted members with the necessary experience in finance, audit and/or risk matters.

In terms of its mandate, the Committee reviews and assesses the integrity, quality and effectiveness of risk, internal control, finance and accounting systems and ensures that the associated risk and financial policies and strategies are effectively managed.

The main duties of the Audit & Risk Committee are to:

- Review the quarterly and annual financial accounts before their submission to the Board and monitor the controls which are in force to ensure the integrity of the information reported to the shareholder;
- Advise the Board on the appointment of external and internal auditors and on their remuneration both for audit and non-audit work, as well as discussing the nature, scope, fees and results of the audit with external and internal auditors. The Committee also reviews the cost effectiveness and the independence and objectivity of the external auditors;
- Provide a forum for reporting by the external and internal auditors;
- Perform the duties required of it in terms of the Audit & Risk Committee Charter which is reviewed annually;
- Provide an independent and objective oversight and review of the information provided by management on corporate accountability and associated risks;
- Oversee the quality, integrity and reliability of the group's risk management function;
- Review the risk management framework and assess the integrity and the quality of risk control systems and ensure that risk strategies and policies are effectively managed;
- Ensure that there are proper strategies, policies and procedures in place in the group to control:
  - The investment of surplus funds and reserves; and
  - Reserves and provisions required by the Short Term Insurance Act and the Financial Services Board.

The Committee met four times during the financial year.

Investment Committee

The Committee consists of five non-executive directors and two independent non-executive co-opted members. The Committee has been established by the Board to act in the capacity of a credit assessment committee in respect of the group and its duties are as follows:

- Ensure that there are proper strategies, policies and procedures in place to control:
  - the granting and management of credit;
  - the products offered by the group;
  - equity investments; and
  - the property portfolio.
- Authorise new lending, property transactions and equity investments within its delegated levels of authority and recommend those above its level of authority to the Board for approval;
- Request the Board to amend the strategies, policies and procedures from time to time as it deems necessary relating to its areas of responsibility; and
- Authorise the conversion of loans to grants, write-offs and ensure that an appropriate level of provisions is held against the loan and indemnity books.

The Committee approves financing between R5 million and R20 million. The Committee met five times during the financial year.

Human Resources Management and Remuneration Committee

The Committee consists of five non-executive directors and may elect at least two independent non-executive co-opted members. The Committee advises the Board on remuneration policies and packages, and other terms of employment for all employees, senior executives, the Managing Director and individual directors. Other areas of responsibility included in the Committee's terms of reference are:

- Performance management;
- Recommend to the Board the approval of all Khula human resources policies and procedures and ensuring that such policies and procedures are in line with applicable labour legislation; and
- Assisting with industrial relations in respect of disputes, mediation, etc. and the relationship between Khula and its employees.

The Committee met four times during the financial year.

Board and Committee Attendance Record

The record of attendance by each director and co-opted member at Khula Board and Board Committee meetings for the financial year ended 31 March 2007, is set out in the table below:

	Board	Investment	Human Resources	Audit & Risk	Tender Committee
Number of meetings	6	5	4	4	2
XGS Sithole	6	5	4	4	2
NT Mapetla	6	-	3*	-	-
YG Benn	5*	-	4	-	-
N Greenhill	1*	3*	-	-	-
N Lala-Mohan	1*	0*	0*	-	-
M Manjezi[1]	2	-	-	-	-
N Mashiya	2*	-	-	3*	-
ML Mkhize	5	3*	-	3*	2
M Mohoto[2]	1	-	-	-	-
GMB Mokoena	4*	2*	-	-	-
NC Msizi	4*	-	1*	-	-
X Ncame[3]	0*	-	-	1*	-
IAS Tayob	6	-	-	4	2
DMN Thabaneng	5*	-	3*	-	1*
M Zungu	4*	4*	-	-	-
Co-opted members					
M Ferreira	-	5	-	-	-
B Ngubane	-	-	2	-	-

* *indicates absence with apology*

[1] *appointed on 6 December 2006*

[2] *resigned on 5 December 2006*

[3] *resigned on 26 February 2007*

Ethical Standards

Khula recognises the need for directors and employees to observe the highest standards of behaviour and business ethics when engaging in business activities. All directors and employees are expected to act in accordance with the law and with the highest standards of propriety and to comply with Khula's Code of Ethics.

Khula is committed to high standards of corporate governance. The Board is accountable to the company's shareholder and stakeholders, promoting good corporate governance.

Relations with Shareholder

Communication with the shareholder is given high priority. There is regular dialogue with the shareholder to foster mutual understanding of objectives. The relationship is further governed through both parties signing an annual Shareholders Compact.

Risk Management

Effective risk management is integral to Khula's objective of consistently adding value to the business. Management is continuously developing and enhancing its risk and control procedures to improve the mechanisms for identifying, monitoring and mitigating risks. The Audit & Risk Committee as well as the Board of Directors monitors areas of significant business risk on a continuous basis. Once particular risks are identified, it is the responsibility of the Board to ensure that management takes such action as required to minimise the risk.

Risk management is dealt with in detail in the report of the Risk and Compliance Division, which forms part of the annual report and financial risk management is dealt with in the financial statements (refer to note 1.17).

Internal Control

The Board has overall responsibility for establishing and maintaining the group's system of internal control and for reviewing its effectiveness. The directors have reviewed the effectiveness of the system of internal controls in operation throughout the year. The role of the group's management is to implement Board policies on risk and control. Khula's management operates an ongoing risk management process for identifying, evaluating and managing the significant risks faced by Khula. This process is reviewed by the Board during the year.

To meet its responsibility with respect to providing reliable financial information, Khula and its subsidiaries maintain financial and operational systems of internal control. These controls are designed to provide reasonable assurance that transactions are concluded in accordance with management's authority, that the assets are adequately protected against material loss or unauthorised acquisition, use, or disposal, and that transactions are properly authorised and recorded. This system includes a documented organisational structure and division of responsibility, established policies, and procedures, including a Code of Ethics to foster a strong ethical climate, which are communicated throughout the group. It also includes careful selection, training, and development of people.

The group does not have its own internal audit department, however the situation is reviewed periodically by the Board to assess whether circumstances have changed to warrant its introduction. An independent reputable internal audit firm has been appointed to conduct internal audit assessments. The internal auditors assist the Board with the monitoring of the operation of the internal control system and report their findings and recommendations to management and the Audit & Risk Committee. Corrective actions are taken to address control deficiencies and other opportunities for improving the system as they are identified. The Board, operating through its Audit & Risk Committee, provides supervision of the financial reporting process and internal control system.

There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation and the safeguarding of assets. Furthermore, the effectiveness of an internal control system can change with circumstances.

The key procedures, which the directors have established to review the effectiveness of the system of internal control, include the following:

- *Management structure*

  The Board has overall responsibility for the group and there is a formal schedule of matters specifically reserved for decision by the Board. The Managing Director, as executive director, together with key senior executives constitutes the Executive Committee, which meets regularly, to discuss day-to-day operational matters. The Managing Director also meets regularly with the senior executives of the divisions, together with their management teams.

- *Risk assessment*

  The risk register identifies the key risks facing the business, the probability of those risks occurring, the impact should the risk occur, and the actions being taken to manage those risks to the appropriate level. The risk assessment is performed on a continuous basis and reports are submitted to the Board periodically to update them on progress as appropriate.

- *Quality and integrity of staff*

  The integrity and competency of staff is ensured through high recruitment standards and subsequent training courses. High quality staff is seen as an essential part of the control environment and are evaluated against a performance management system.

- *Budgetary process*

  Each year the Board approves the annual budget and updated business plan. Key risk areas are identified, performance is monitored and relevant action is taken throughout the year via quarterly reporting to the Board of variances from the budget, updated forecasts for the year together with information on key risk areas.

- *Capital expenditure*

  Capital expenditure is regulated by budgetary processes and authorisation levels. For expenditure beyond specified levels, detailed written proposals have to be submitted to the Board.

- *Audit & Risk Committee*

  The Audit & Risk Committee monitors, through reports to it by the Chief Financial Officer, the controls which are in force and any perceived gaps in the control environment. The Audit & Risk Committee also considers and determines relevant action in respect of any control issues raised by management, the internal auditors or the external auditors.

Public Finance Management Act (PFMA) and other Relevant Laws and Regulations

Since the introduction of the PFMA, there has been an ongoing process of awareness at Khula. Workshops are held on a continuous basis as an integral part of the training and development of staff. New employees are made aware of the policies and procedures of the company, including the relevant laws and regulations, one of which is the PFMA.

All the measures introduced in past years are constantly reviewed and improved upon to ensure increased awareness. Employees and management of Khula are aware of the consequences of breaching the provisions of the PFMA.

As the Accounting Authority for the company, the Board of Directors is informed about occurrences and they are aware of their responsibilities in terms of the Act. The directors comply with their fiduciary duties as set out in this Act and the Companies Act. During the year under review there were no known material occurrences pertaining to fraud or irregularities or cases of fruitless and/or wasteful expenditure.

Statement of Responsibility by the Board of Directors

The Public Finance Management Act of 1999 (PFMA) requires that the directors ensure that Khula Enterprise Finance Limited and its subsidiaries (Khula) keep full and proper records of its financial affairs. The financial statements should fairly present the state of affairs of Khula, its financial results, its performance against predetermined objectives and its financial position at the end of the year in terms of South African Statements of Generally Accepted Accounting Practices (GAAP).

In accordance with Companies Act requirements, the directors are responsible for the annual financial statements. The external auditors are responsible for independently auditing and reporting on the financial statements.

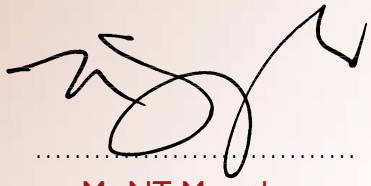
The directors are ultimately responsible for the internal controls. Management enables the directors to meet these responsibilities. Standards and systems of internal control are designed and implemented by management to provide reasonable assurance as to the integrity and reliability of the financial statements in accordance with GAAP and to adequately safeguard, verify and maintain accountability for company assets. Accounting policies supported by judgements, estimates and assumptions which comply with GAAP, are applied on a consistent and going concern basis. Systems and controls include the proper delegation of responsibilities with a clearly defined framework, effective accounting procedures and adequate segregation of duties.

The directors are of the opinion, based on the information and explanations given by management and the internal auditors and discussions with the independent external auditors on the result of their audits, that the internal accounting controls are adequate to ensure that the financial records may be relied upon for preparing the financial statements, and accountability for assets and liabilities is maintained.

Nothing has come to the attention of the directors to indicate that any breakdown in the functioning of these controls, resulting in material loss to the company, has occurred during the year and up to the date of this report. The directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

In the opinion of the directors, based on the information available to date, the financial statements fairly present the financial position of Khula at 31 March 2007 and the results of its operations and cash flow information for the year.

The financial statements prepared in accordance with GAAP, which appear on pages 61 to 117, were approved by the Board of Directors on 16 August 2007 and signed on its behalf by:



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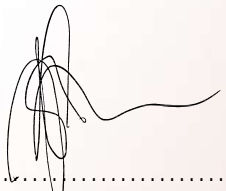
Ms NT Mapetla
Chairperson



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Mr XGS Sithole
Managing Director

Khula Enterprise Finance Limited and its Subsidiaries
Certification by the Company Secetary for the year ended 31 March 2007

In terms of Section 268 G(d) of the Companies Act, 1973 as amended, I hereby certify that the company has, in respect of the financial year reported upon, lodged with the Registrar of Companies all such returns as are required by the Companies Act, 1973, as amended, and that all such returns are true, correct and up to date.

.....

Mr B Dlamini
16 August 2007

Report of the Audit and Risk Committee for the year ended 31 March 2007

Report of the Audit and Risk Committee in terms of Regulation 27(1)(7)(b) and (c) of the Public Finance Management Act of 1999, as amended.

In execution of its duties during the past financial year, the Audit and Risk Committee has:

- Reviewed the procedures for identifying business risks and controlling their impact on the group;
- Reviewed the group's policies and procedures for detecting and preventing fraud;
- Reviewed the operational effectiveness of the group's policies, systems and procedures;
- Considered whether the independence, objectives, organisation, staffing plans, financial budgets, audit plans and standing of the internal audit function provide adequate support to enable the Committee to meet its objectives;
- Reviewed the results of the work performed by the internal audit function on financial reporting, corporate governance, internal control and any significant investigations and management response;
- Reviewed the co-ordination between the internal audit function and the external auditors and dealt with any issues of material or significant dispute or concern;
- Reviewed such significant cases of employee conflicts of interest, misconduct or fraud, or any other unethical activity by employees or the group as reported by management;
- Reviewed the controls over financial and certain operational risks;
- Reviewed any other relevant matters referred to it by the Board;
- Reviewed the quality of financial information;
- Reviewed the annual financial statements taken as a whole to ensure they present a balanced and understandable assessment of the position, performance, and future viability of the company;
- Reviewed the external auditor's report;

- Discussed problems and reservations arising from the external audit, and any matters the external auditors wished to discuss (in the absence, where requested by the Committee, of executive directors and any other person who is not a member of the Committee);
- Reviewed the external auditor's management letter and management's response;
- Reviewed the credibility, independence and objectivity of the external auditors; and
- Satisfied its responsibilities in terms of the Audit and Risk Committee Charter

Where weaknesses were identified in the internal controls, corrective action has been taken to eliminate or reduce the concomitant risks. Accordingly, in our opinion, the internal controls of the group are effective to ensure that the group's assets were safeguarded, proper accounting records were maintained and resources were utilised efficiently.

Following our review of the annual financial statements for the year ended 31 March 2007, we are of the opinion that, in all material respects, they comply with the relevant provisions of the Public Finance Management Act, 1999, as amended, and South African Statements of Generally Accepted Accounting Practice, and that they fairly present the results of operations, cash flows, and the financial position of the company and the group. We have therefore recommended that the financial statements as submitted be approved by the Board of Directors of the company.

On behalf of the Audit and Risk Committee

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Mr Ismail Tayob
Chairperson
16 August 2007

To the member of Khula Enterprise Finance Limited

We have audited the annual financial statements and the group annual financial statements of Khula Enterprise Finance Limited, which comprise the balance sheets at 31 March 2007 and the income statements, the statements of changes in equity and cash flow statements for the year then ended, and the notes to the annual financial statements, which include a summary of significant accounting policies and other explanatory notes as set out on pages 61 to 117.

Directors' responsibility for the financial statements

The company's directors are responsible for the preparation and fair presentation of these financial statements in accordance with South African Statements of Generally Accepted Accounting Practice, in the manner required by the Companies Act in South Africa, the Public Finance Management Act of 1999 as amended and the Public Audit Act of 2004. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the audtor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Auditor's opinion paragraph

In our opinion:

- these financial statements present fairly, in all material respects the financial position of Khula Enterprise Finance Limited and of the group as of 31 March 2007, andof their financial performance and their cash flows for the year then ended in accordance with South African Statements of Generally Accepted Accounting Practice, in the manner required by the Companies Act of South Africa, the Public Finance Management Act of 1999, as amended and the Public Audit Act of 2004.
- the transactions of the company and the group that had come to our attention during the course of the audit were in all material respects in accordance with the mandatory functions of Khula, as determined by law or otherwise.

Sizwe Ntsaluba VSP

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Sizwe Ntsaluba VSP
Partner: A B Mthimunye
Chartered Accountant (SA)
Registered Auditor,
16 August 2007
Johannesburg

Khula Enterprise Finance Limited and its Subsidiaries
Directors' Report for the year ended 31 March 2007

The directors present their report, which forms part of the audited annual financial statements of the company and of the group for the year ended 31 March 2007.

1. Introduction

Khula Enterprise Finance Limited (Khula) was established in 1996 under the Companies Act, by the South African Government. It is a registered limited liability company and listed as a schedule 3B National Government Business Enterprise entity in terms of the Public Finance Management Act, 1999, as amended, (the PFMA) and the related Treasury Regulations.

2. Nature of Business

Khula is a state owned, development finance institution, which provides finance and access to finance to Small and Medium Enterprises (SMEs) through Retail Financial Intermediaries (RFI's) and other suitable financial institutions in the form of loans, equity capital and indemnities. The group also owns a portfolio of business premises that are leased out to commercial undertakings.

Khula's vision is to become a finance partner of first choice in SME development. Its primary focus is to promote sustainable access to loans and equity by SMEs through an effective network of intermediaries by offering a range of financial resources and information to the public, as well as small business premises facilities.

3. Performance

The key financial results are:

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
Revenue	**176,509,202**	140,408,995	**146,598,488**	115,953,442
Operating profit	**38,301,762**	28,410,336	**47,069,560**	34,980,737
Net profit for the year	**31,022,766**	22,000,684	**36,403,762**	26,602,350
Total assets	**1,167,698,916**	1,113,221,565	**1,076,013,374**	1,028,169,868
Total liabilities	**123,273,084**	99,818,499	**30,388,495**	18,948,751

The Group's net profit for the year amounted to R31 million (2006: R22 million), an increase of R9 million compared to the previous year. The increase in net profit of 41 percent is as a result of increased revenue earned on business loans and activities, increased revenue in respect of investment income and significant increases in the fair values of investments and investment properties.

The increase in interest rates has had a positive effect on investment income which registered a R6.9 million (16.5 percent) increase from the previous year. Khula's advances are primarily structured around interest bearing debt, which is linked to jibar and/or prime which is influenced by the prime overdraft rate whereas Khula's investments also earn income linked to the prime overdraft rate.

The average monthly effective interest rate earned during the year was 7.4 percent compared to the average monthly effective interest rate earned in 2006 of 6.6 percent.

An 18.9 percent growth was experienced in interest revenue from lending operations, which is directly attributable to increased loan business and a book growth of 16.4 percent in the current financial year and 8 percent in the previous financial period. Furthermore, the growth of 18 percent in the indemnity book yielded an increase of 13.5 percent in indemnity fees earned. In total the group's total loan and equity book registered an increase of 22 percent.

Khula's loan funding requirements are sourced directly through internally generated funds from its capital base, repayments received, profits and returns from its investments and property portfolio. The general funding requirements for the year amounted to R82 million. This was used to fund core business activities of R57.4 million, capital expenditure of R2 million and operational needs of R22.6 million. The indemnity book growth of R71.2 million places further demands on cash resources. Potential commitments in respect of the core business activities that will have to be funded from cash resources amounts to R466.8 million.

Khula's corporate performance indicators reflect its strategic goals. In the year under review, these included maximising access to finance and its developmental impact together with a focused customer perspective. In addition, Khula measures itself on a range of other indicators, representing critical projects and initiatives that focus on financial sustainability and maximisation of its impact coupled with employee retention, development and management.

Khula's long-term objectives are based on the performance requirements determined by the dti. The performance measurement system ensures that Khula remains aligned with its mandated performance areas. The key performance areas set for the 2006/7 reporting period were:

• Maximising access to finance & development impact	52.5%
• Customer focus/satisfaction	7.5%
• Human resources	15%
• Financial sustainability	20%
• Risk and process management	5%

During the year under review, Khula exceeded its overall target.

3.1 Investments

It is Khula's long term strategic objective to manage more actively its exposure to interest rate changes and build a balanced portfolio.

Non-interest returns on investments such as dividends reflect an increase of 13.5 percent compared to the significant increase in fair value gains of R24 million (162 percent). This is in contrast with a decrease of 18.5 percent in the value of these investments from 2006, which is as a result of the sale of a portion of a listed investment to the value of R36 million. The fair value increase can be attributed to the investment property portfolio, listed shares and an investment in a SME vehicle.

During the year under review the group participated in a Black Economic Empowerment (BEE) transaction where it sold approximately 50 percent of its shareholding in a listed entity. In order to comply with disclosure requirements the details of the transaction are disclosed as follows in the notes to the annual financial statements:

	R'000
Included in fair value gains	7,388
Loss on sale	(7,140)
Included in dividend income	3,006
Profit	3,254

3.2 Investment property portfolio

The portfolio as at 31 March 2007 consisted of 58 properties with a total lettable space of 205,882m². The portfolio is grouped into Northern (57%), Southern (33%) and Eastern Regions (10%) with the following sectoral split:

Industrial	52%
Retail	48%

The industrial portfolio comprises of hives (a building divided into small units and let to informal entrepreneurs for 'start-up' businesses); factories (free standing units ranging from small to large) and industrial parks. The retail portfolio comprises shopping centres.

Khula's property portfolio yielded a return on investment of 16 percent compared against 10 percent in the previous year. This performance also compares favourably with that of the average market performance. Khula is confident that the performance can be improved as the return is diluted by the fact that the portfolio includes a large number of properties (±36 percent) that are situated in uneconomical areas and are plagued by crime and vandalism resulting in low rental returns as well as high maintenance costs. Furthermore, Khula's property portfolio is used for developmental purposes of both local communities and entrepreneurs and therefore prevents Khula from levying market related rentals to maximise returns.

The detailed overview of Khula's performance in terms of its core business activities, operations and development is set out in the annual report and in the Managing Director's report included in the annual report. Further details of the financial results of the company and the group are set out in the attached financial statements.

4. Going Concern

The financial statements have been prepared on the going concern basis, since the directors have every reason to believe that the company and the group have adequate resources in place to continue in operation for the foreseeable future.

5. Dividends

No dividends have been declared during the year and none is recommended (2006: Rnil).

6. Share Capital

The authorised and issued share capital have remained unchanged.

7. Directors

7.1 The directors in office during the financial year were:

Executive:	
XGS Sithole (Managing Director)	
Non executive:	
NT Mapetla (Chairperson)	ML Mkhize (Deputy Chairperson)
YG Benn	N Greenhill
N Lala-Mohan	M Manjezi (appointed 6 December 2006)
N Mashiya	M Mohoto (resigned 5 December 2006)
GMB Mokoena	NC Msizi
X Ncame (resigned 26 February 2007)	IAS Tayob
DMN Thabaneng	M Zungu

7.2 Directors' emoluments

	Remuneration R
Executive director	
XGS Sithole	**1,941,596**
– Basic	1,055,018
– Medical aid	47,100
– Retirement benefits	151,332
– Bonuses and other benefits	688,146
Non-executive directors	**245,000**
NT Mapetla	50,200
YG Benn	30,500
N Greenhill	-
N Lala-Mohan	-
M Manjezi	-
N Mashiya	-
ML Mkhize	41,750
GMB Mokoena	21,050
M Mohoto	-
NC Msizi	12,000
X Ncame	-
IAS Tayob	44,500
DMN Thabaneng	30,000
M Zungu	15,000
	2,186,596

Directors' fees are based on Board and other committee meetings' attendance plus payments made for any additional services delivered to Khula.

8. Director's Interest in Contracts

No material contracts were entered into involving the interest of any director.

9. Equipment

There were no major changes in the equipment during the year or any changes in the policy relating to its use.

10. Holding Company

The company is a wholly owned subsidiary of Ernani Investments (Proprietary) Limited (incorporated in South Africa and owned by the Department of Trade and Industry of the Government of South Africa).

11. Subsidiaries

The interest of the company in the aggregate net income and losses of subsidiaries is:

	2007 R	2006 R
Net income	**6,267,346**	390,998
Losses	**(11,657,342)**	(4,992,664)
	(5,380,996)	(4,601,666)

Details of the subsidiaries are set out in note 8 of the annual financial statements.

12. Events after the Balance Sheet Date

The directors are not aware of any matter or circumstance arising since the end of the financial year, not otherwise dealt with in the report that would affect the operations of the company or the group significantly.

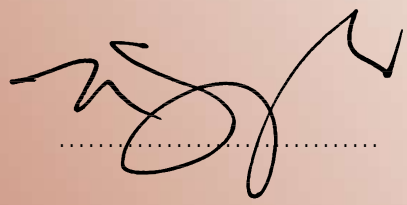
13. Company Secretary

The secretary during the year up to 21 November 2006 was Ms E Isenschmid and from 1 February 2007 is Mr B Dlamini. His business and postal address are as follows:

Physical Address	Postal Address
The dti Campus	P O Box 28423
77 Meintjie Street	Sunnyside
Sunnyside	0132
Pretoria	

14. Auditors

SizweNtsaluba VSP will continue in office in accordance with section 270(2) of the Companies Act.



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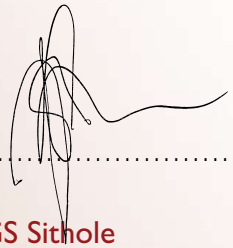
Ms NT Mapetla
CHAIRPERSON



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Mr XGS Sithole
MANAGING DIRECTOR

Khula Enterprise Finance Limited and its Subsidiaries
Balance Sheets at 31 March 2007

	Note	Group 2007 R	Group 2006 R	Company 2007 R	Company 2006 R
ASSETS					
Non-current assets		**490,960,663**	460,697,861	**549,612,626**	521,868,172
Office equipment, furniture and other tangible assets	2	**2,075,010**	1,820,660	**2,075,010**	1,820,660
Loans and advances	3	**148,518,387**	136,887,994	**148,518,387**	136,887,994
Related party loans	4	**7,629,583**	1,775,455	**7,629,583**	1,775,455
Investment properties	5	**151,498,005**	142,811,779	**151,498,005**	142,811,779
Investments	6	**173,239,678**	175,342,916	**159,475,161**	166,224,828
Investment in associate	7	**8,000,000**	2,059,057	**8,000,000**	2,000,000
Investments in subsidiaries and joint venture	8			**72,416,480**	70,347,456
Deferred tax	9	**7,442,566**	9,293,698	**-**	-
Current assets		**669,295,687**	643,230,006	**526,400,748**	506,301,696
Trade and other receivables		**7,865,129**	9,386,505	**6,440,365**	9,038,689
Cash and cash equivalents	25	**661,430,558**	633,843,501	**519,960,383**	497,263,007
TOTAL ASSETS		**1,167,698,916**	1,113,221,565	**1,076,013,374**	1,028,169,868
EQUITY AND LIABILITIES					
Capital and reserves		**1,044,425,832**	1,013,403,066	**1,045,624,879**	1,009,221,117
Share capital	10	**308,300,000**	308,300,000	**308,300,000**	308,300,000
Reserves		**195,744,701**	164,721,935	**196,943,748**	160,539,986
Shareholders' loan	11	**540,381,131**	540,381,131	**540,381,131**	540,381,131
Non-current liabilities		**50,472,000**	38,502,158	**-**	802,158
Related party loans	4	**-**	802,158	**-**	802,158
Indemnity reserves	12	**50,472,000**	37,700,000	**-**	-
Deferred tax	9	**-**	-	**5,772,245**	475,254
Current liabilities		**72,801,084**	61,316,341	**24,616,250**	17,671,339
Claims provision	13	**39,107,000**	35,200,000	**-**	-
Other provisions	14	**5,583,760**	4,074,977	**5,583,760**	3,808,525
Trade and other payables		**18,487,080**	16,547,835	**14,098,077**	13,058,116
Tax payable		**9,623,244**	5,493,529	**4,934,413**	804,698
TOTAL EQUITY AND LIABILITIES		**1,167,698,916**	1,113,221,565	**1,076,013,374**	1,028,169,868

Khula Enterprise Finance Limited and its Subsidiaries
Income Statement for the year ended 31 March 2007

	Note	Group 2007 R	Group 2006 R	Company 2007 R	Company 2006 R
Revenue		**176,509,202**	140,408,995	**146,598,488**	115,953,442
Indemnity fees		**13,514,706**	11,907,688	**-**	-
Interest from lending operations		**15,287,473**	12,857,808	**14,553,097**	11,462,353
Investment property rental income	15	**37,749,141**	36,812,956	**37,749,141**	36,812,956
Other income	16	**10,203,677**	11,499,121	**15,361,723**	10,813,921
Investment income	17	**60,848,108**	52,500,614	**48,053,745**	42,076,853
Net fair value gain on financial and other assets	18	**38,906,097**	14,830,808	**30,880,782**	14,787,359
Expenses		**(138,207,440)**	(111,998,659)	**(99,528,928)**	(80,972,705)
Staff costs	19	**(23,494,233)**	(17,442,715)	**(23,494,233)**	(16,257,131)
Investment property expenses	20	**(35,578,443)**	(33,694,310)	**(35,578,443)**	(33,694,310)
Other operating expenses		**(79,134,764)**	(60,861,634)	**(40,456,252)**	(31,021,264)
Operating profit	21	**38,301,762**	28,410,336	**47,069,560**	34,980,737
Share of (loss)/profit of associate		**(59,057)**	59,057	**-**	-
Profit before tax		**38,242,705**	28,469,393	**47,069,560**	34,980,737
Tax	22	**(7,219,939)**	(6,468,709)	**(10,665,798)**	(8,378,387)
Net profit for the year		**31,022,766**	22,000,684	**36,403,762**	26,602,350

Khula Enterprise Finance Limited and its Subsidiaries
Statement of changes in equity for the year ended 31 March 2007

	Share Capital	Contingency Reserve	Danida Reserve*	Accumulated Surplus	Total
	R	R	R	R	R
GROUP					
Balance at 1 April 2005	308,300,000	996,393	10,154,810	131,570,048	451,021,251
Net profit for the year	-	-	-	22,000,684	22,000,684
Transfer from income statement	-	194,376	-	(194,376)	-
Balance at 31 March 2006	**308,300,000**	**1,190,769**	**10,154,810**	**153,376,356**	**473,021,935**
Net profit for the year	**-**	**-**	**-**	**31,022,766**	**31,022,766**
Transfer from income statement	**-**	**160,702**	**-**	**(160,702)**	**-**
Balance at 31 March 2007	**308,300,000**	**1,351,471**	**10,154,810**	**184,238,420**	**504,044,701**
COMPANY					
Balance at 1 April 2005	308,300,000	-	-	133,937,636	442,237,636
Net profit for the year	-	-	-	26,602,350	26,602,350
Balance at 31 March 2006	**308,300,000**	**-**	**-**	**160,539,986**	**468,839,986**
Net profit for the year	**-**	**-**	**-**	**36,403,762**	**36,403,762**
Balance at 31 March 2007	**308,300,000**	**-**	**-**	**196,943,748**	**505,243,748**

*This reserve arises from expired credit indemnities funded by the government of Denmark, out of which Khula Credit Guarantee Limited may issue its own further credit indemnities.

Khula Enterprise Finance Limited and its Subsidiaries
Cash Flow Statements for the year ended 31 March 2007

	Note	Group 2007 R	Group 2006 R	Company 2007 R	Company 2006 R
Net cash flow from operating activities					
Cash utilised by operations	23	**(21,407,207)**	(28,294,762)	**(12,320,961)**	(18,201,113)
Tax paid	24	**(1,239,092)**	(8,263,932)	**(1,239,092)**	(8,263,932)
Net cash from operating activities		**(22,646,299)**	(36,558,694)	**(13,560,053)**	(26,465,045)
Net cash flow from investing activities					
Purchase of office equipment, furniture and other tangible assets		**(1,476,548)**	(877,919)	**(1,476,548)**	(877,919)
Increase in loans and advances		**(22,824,451)**	(18,061,022)	**(22,824,451)**	(18,061,022)
Capital improvements to investment properties		**(521,920)**	(2,776,837)	**(521,920)**	(2,776,837)
Increase in private equity, joint venture and other investments		**(21,931,648)**	(6,675,681)	**(23,417,488)**	(7,517,217)
Investment in associate		**(6,000,000)**	(688,790)	**(6,000,000)**	(688,790)
Loans made to subsidiaries and related parties		**(7,665,523)**	(652,331)	**(7,665,523)**	(652,331)
Loan repayments received from subsidiaries and related parties		**1,009,237**	53,669,891	**1,313,513**	53,669,891
Proceeds from sale of equipment		**88,230**	-	**88,230**	-
Proceeds from sale of investment properties		**12,461,133**	8,168,832	**12,461,133**	8,168,832
Proceeds from sale of listed investment		**36,246,738**	-	**36,246,738**	-
Interest received		**48,886,159**	41,958,753	**37,845,780**	32,493,704
Dividends received		**11,961,949**	10,541,861	**10,207,965**	9,583,149
Net cash from investing activities		**50,233,356**	84,606,757	**36,257,429**	73,341,460
Net cash flow from financing activities					
Grant funds utilised		**-**	(1,350,583)	**-**	-
Net cash from financing activities		**-**	(1,350,583)	**-**	-
Net increase in cash and cash equivalents		**27,587,057**	46,697,480	**22,697,376**	46,876,415
Cash and cash equivalents at beginning of year		**633,843,501**	587,146,021	**497,263,007**	450,386,592
Cash and cash equivalents at end of year	25	**661,430,558**	633,843,501	**519,960,383**	497,263,007

1. Significant Accounting Policies

The principal accounting policies adopted in the preparation of these financial statements are set out below:

1.1 Basis of preparation

The financial statements have been prepared in accordance with South African Statements of Generally Accepted Accounting Practice (GAAP) adopted by the Accounting Practices Board in South Africa and interpretations issued by the International Financial Reporting Interpretation Committee (IFRIC).

The financial statements have been prepared using the historical cost convention as modified by the revaluation of investment properties and certain financial assets and financial liabilities held at fair value. In the current year's financial statements, the principal accounting policies set out below were consistently applied in all material respects with those of the previous year.

The preparation of financial statements in conformity with GAAP requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. There, does, however, not appear to be a significant risk that these assumptions will cause significant adjustments to the carrying amount of assets and liabilities within the subsequent financial years, however actual results may ultimately differ from these estimates.

The directors believe that Khula Enterprise Finance Limited has adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements of the company and the group have been prepared on a going-concern basis.

1.2 Group accounting

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the company and entities controlled by the company. Control is obtained where the company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Subsidiaries

Subsidiaries, which are those entities in which the group has an interest of more than half the voting rights or otherwise has power to govern the financial and operating policies, are consolidated. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the group controls another entity.

Subsidiaries are consolidated from the date on which control has transferred to the group and are no longer consolidated from the date that control ceases.

All intercompany transactions and balances between group enterprises are eliminated on consolidation.

Joint ventures

A joint venture is a contractual arrangement whereby the group and other parties undertake an economic activity that is subject to joint control. Joint control is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

The group reports its interest in jointly controlled entities using the proportionate consolidation method of accounting. The group's share of assets, liabilities, income and expenses and cash flows of jointly controlled entities are combined with the equivalent items in the financial statements on a line by line basis.

The accounting policies of the joint ventures are consistent with the policies adopted by the company. Unrealised profits and losses are eliminated to the extent of the group's interest in the joint venture except where unrealised losses provide evidence of an impairment of the assets transferred.

1.3 Financial instruments

Recognition and measurement

Financial assets and financial liabilities are recognised on the balance sheet when the group becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially recognised at their fair value plus in the case of all financial assets not carried at fair value through profit and loss, transaction costs that are directly attributable to their acquisition. Purchase and sales of financial instruments are recognised on a trade-date basis.

Financial liabilities and equity instruments, issued by the group, are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. Financial liabilities are removed from the balance sheet when the obligation specified in the contract is discharged, cancelled or expires.

Financial assets are derecognised when and only when:

– The contractual rights to the cash flows from the financial assets expire; or

– The group transfers the financial asset including substantially all the risk and rewards of ownership of the asset.

A financial liability is derecognised when and only when the liability is extinguished, that is, when the obligation specified in the contract is discharged, cancelled or has expired. The difference between the carrying amount of the financial liability (or part thereof) extinguished or transferred to another party and consideration paid, including non-cash assets transferred or liabilities assumed, is recognised in profit or loss.

Investments made by the group are classified as either held at fair value through profit or loss or available-for-sale, and are measured at subsequent reporting dates at fair value.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair values of quoted investments and unit trusts in active markets are based on current market prices. Since actual market prices are available in determining fair values, no significant estimates or valuation models are applied in determining the fair value of quoted financial instruments.

Financial assets

Financial assets are classified into the following categories: financial assets at fair value through profit or loss; loans and receivables and available-for-sale financial assets. Management determines the classification of financial assets at initial recognition.

(a) Financial assets at fair value through profit or loss

This category has two components: those held for trading, and those designated at fair value through profit and loss at inception. A financial asset is classified in this category if acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, or a security is included in a portfolio in which a pattern of short-term profit taking exists or if so designated by management at inception as held at fair value through profit or loss.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These arise when the group provides money, goods or services to a debtor with no intention of trading the receivable.

(c) Available-for-sale

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Financial liabilities

Financial liabilities are recognised initially at fair value, generally being their issue proceeds net of transaction costs incurred. Financial liabilities are subsequently stated at amortised cost and interest is recognised over the period of the borrowing using the effective interest method.

(a) Gains and losses

Gains and losses arising from changes in the fair value of the financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity is recognised in profit or loss. Interest, calculated using the effective interest method, is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the group's right to receive payment is established.

(b) Loans and receivables

Loans and receivables are carried at amortised cost using the effective interest method.

After initial recognition, financial liabilities are measured at amortised cost, using the effective interest method, except for financial liabilities through profit and loss which are measured at fair value.

The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or, realise the asset and settle the liability simultaneously.

Loans and advances

Loans and advances are classified on initial recognition as loans and receivables. Loans and advances classified as loans and receivables are financial assets with fixed or determinable payments that are

not quoted in an active market. Loans and advances are accounted for at amortised cost using the effective interest method. Origination transaction costs and origination fees received are capitalised to the value of the loan and amortised through interest income. Where the group has elected to classify and account for any loan as a financial asset at fair value through profit or loss, the movement in the fair value is accounted for in the income statement as interest income.

1.4 Impairment of financial assets

Assets carried at amortised cost

At each reporting date, the group assesses whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of assets (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it then includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in the collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate of measuring any impairment loss is the current effective interest rate determined under the contract.

When a loan is uncollectable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

If, in the subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal is recognised in the income statement.

Assets carried at fair value

At each reporting date, the group assesses whether there is objective evidence that a financial asset or group of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement.

Impairment losses recognised in the income statement on equity instruments classified as available-for-sale are not subsequently reversed through the income statement. However, in a subsequent period the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

1.5 Office equipment, furniture and other tangible assets

Office equipment, furniture and other tangible assets are stated at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes all expenditure that is directly attributable to bringing the asset to working condition for its intended use.

Subsequent costs are included in the carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation is calculated on the straight-line method to allocate their cost to their residual values on a systematic basis over their estimated useful lives as follows:

Computer equipment	3 years
Office equipment	6 years
Furniture and fittings	6 years
Motor vehicles	5 years

Each part of an item of office equipment, furniture and other tangible assets with a cost that is significant in relation to the total cost of the item is depreciated separately.

The assets' residual values, useful lives and depreciation method are reviewed on an annual basis and are adjusted if appropriate.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount of the asset.

1.6 Impairment of tangible and intangible assets

At each balance sheet date, the group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverability of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs. An intangible asset with an indefinite useful life is tested for impairment annually and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value, less costs to sell, and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately.

1.7 Investment properties

Investment properties, principally comprising retail and industrial buildings, are held for long-term rental yields and are not occupied by the group. Investment properties are treated as a long-term investment and are carried at fair value, representing open market value determined annually by external valuers. Changes in fair values are recorded as part of operating income in the income statement.

1.8 Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, demand deposits and other short-term, highly liquid, investments that are convertible to a known amount of cash which are subject to insignificant risk of changes in value, all of which are available for use by the group unless otherwise stated.

1.9 Taxation

The tax expense represents the sum of the current tax payable and deferred tax.

The current tax payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statement and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which the temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and joint ventures, except where the group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

1.10 Employee benefits

Pension and provident fund obligations

The group has a provident fund scheme which is a defined contribution plan. A defined contribution plan is a pension plan under which the group pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior periods.

The group pays contributions to publicly or privately administered provident fund plans on a mandatory, contractual, and voluntary basis. Once the contributions have been paid, the group has no further payment obligations. The regular contributions constitute net periodic costs for the year in which they are due, and as such are included in staff costs.

Termination benefits

Termination benefits are payable whenever an employee's employment is terminated before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The group recognises termination benefits when it is demonstratively committed either to terminate the employment of current employees according to a detailed formal plan without possibility of withdrawal, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy.

Profit sharing and bonus plans

A liability for employee benefits in the form of profit sharing and bonus plans is recognised in other provisions when there is no realistic alternative but to settle the liability, and at least one of the following conditions are met:

– there is a formal plan and the amounts to be paid are determined before the time of issuing the financial statements; or

– past practice has created a valid expectation by the employees that they will receive a bonus/profit sharing and the amount can be determined before the time of issuing the financial statements.

Liabilities for profit sharing and bonus plans are expected to be settled within twelve months and are measured at the amounts expected to be paid when they are settled. The final bonus is also subject to staff being in the employ of the company on date of payment.

Short-term employee benefits

The cost of short-term employee benefits (those payable within 12 months after service is rendered) such as paid vacation, leave pay, sick leave and bonuses arerecognised in the period in which the service is rendered and is not discounted. The expected cost of short-term accumulating compensated absences is recognised as an expense as the employees render services that increases their entitlement or, in the case of non-accumulating absences, when the absences occur.

Provisions for leave pay and bonuses are recognised as a liability in the financial statements.

1.11 Share capital

Ordinary shares are classified as equity and are recorded at the proceeds received net of incremental external costs directly attributable to the issue.

1.12 Grants received from donors

Donor funding is recognised at its fair value where there is reasonable assurance that the funding will be received and the group will comply with all attached conditions.

Funding relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs for which they are intended to compensate and is included in non-current liabilities.

1.13 Provisions

Provisions are recognised when the group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation. Provisions are measured at the directors' estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material. Where the group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain.

Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

1.14 Indemnities

Indemnity contracts - classification

Contracts under which the group accepts significant indemnity risk from another party (the indemnity holder) by agreeing to compensate the indemnity holder or other beneficiary if a specified uncertain future event (the indemnified event) adversely effects the indemnity holder are classified as indemnity contracts. Indemnity risk is a risk other than financial risk. Indemnity contracts may also transfer some financial risk.

Indemnity contracts

The group developed its accounting policies for indemnity contracts before the adoption of AC 141 and in the absence of a specific standard for indemnity contracts. The directors used their judgement in developing a set of accounting policies for the recognition and measurement of rights and obligations arising from indemnity contracts issued which provides the most useful information to users of the group's financial statements. In making this judgement, the directors primarily considered the guidance issued by the South African Institute of Chartered Accountants.

Recognition and measurement of indemnity fees

Gross fees comprise the fees on contracts entered into during the year, irrespective of whether they relate in whole or in part to a later accounting period. Fees written include adjustments to fees written in prior accounting periods and estimates for 'pipeline fees' (fees written relating to current accounting period but not reported by the balance sheet date).

Fees are earned from the date the risk attaches, over the indemnity period, based on the pattern of the risk underwritten. Gross fees exclude value-added-tax.

Indemnity reserves

Indemnity reserves consist of:

(i) Provision for unearned fees

Unearned fees, which represent the proportion of fees written in the current year which relate to risks that have not expired by the end of the financial year, are calculated on the 365th basis.

(ii) Provision for unexpired risk

Provision is made for unexpired risks where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned

fee provision in relation to such policies. The provision for unexpired risks is calculated separately by reference to class of business that are managed together, after taking into account the relevant investment returns.

Provision for claims

Provision is made on a prudent basis for the estimated final cost of all claims that had not been settled on the accounting date, less amounts already paid based on calculations performed by independent actuaries. Claims and loss adjustment expenses are charged to income as incurred based on the estimated liability for compensation owed to indemnity holders. The group's own assessors individually assess claims. The claims provision includes an estimated portion of the direct expenses of the claims.

Provision is also made for claims arising from indemnified events that occurred before the close of the accounting period, but which had not been reported to the group by that date.

Whilst the directors consider that the gross provisions are fairly stated on the basis of the information currently available to them, the ultimate liability may vary as a result of subsequent information and events and may result in significant adjustments to the amounts provided. The methods used to calculate these provisions, and the estimates made, are revised regularly.

Statutory contingency reserve

A statutory contingency reserve for catastrophes is provided as required by the Short Term Insurance Act No. 53 of 1998 (repealed Act 1953). The company is required to raise a contingency reserve of 10% of gross indemnity fees raised. The reserve can be utilised only with prior permission of the Financial Services Board. Transfers to this reserve are reflected in the statements of changes in equity, and are indicated in the balance sheet as part of 'Reserves' under capital and reserves

Receivables and payables related to indemnity contracts

Receivables and payables are recognised when due. These include amounts due to and from indemnity contract holders and are included under receivables and payables. If there is objective evidence that the indemnity receivable is impaired, the group reduces the carrying amount of the indemnity receivable accordingly and recognises the impairment loss in the income statement. The group gathers the objective evidence that an indemnity receivable is impaired using the same process adopted for loans and receivables. The impairment loss is calculated under the same method used for financial assets.

Salvage reimbursements

The indemnity contracts require the indemnified party to make all reasonable efforts to recover as much of the loss as possible and to refund the group its proportionate share of the claim incurred. Estimates of these salvage recoveries are included as an allowance in the measurement of the indemnity liability for claims. The allowance is the assessment of the group's share of the amount that can be recovered from the action against the liable third party.

Claims incurred

Claims incurred consist of claims and claims handling expenses paid during the financial year. The movement in the provision for outstanding claims is disclosed separately in the notes to the income statement.

Liability adequacy test

At each balance sheet date, liability adequacy tests are performed to ensure the adequacy of the contract liabilities. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses are used. Any deficiency is immediately charged to profit or loss by establishing a provision for losses arising from liability adequacy tests (the unexpired risk provision).

The ultimate liability arising from claims made under indemnity contracts

The estimation of the ultimate liability arising from claims made under indemnity contracts is one of the group's most critical accounting estimates. Several sources of uncertainty have to be considered in estimating the liability that the group will ultimately be exposed to for such claims. The risk environment can change quickly and unexpectedly owing to a wide range of events or influences. The group is constantly refining the tools with which it monitors and manages risk to place the group in a position to assess risk situations appropriately, despite the greatly increased pace of change. The growing complexity and dynamism of the environment in which we operate means that there are natural limits, however. There cannot and never will be absolute security when it comes to identifying risks at an early stage, measuring them sufficiently, or correctly estimating their real hazard potential. Refer to note 1.17 – Management of financial and indemnity risks for further detail on the estimation of the claims liability.

1.15 Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal cause of business net of vat and other related sales taxes.

Revenue is recognised when it is probable that the economic benefits associated with the transaction will flow to the group and the amounts of revenue can be reliably measured. In the event that there is uncertainty regarding the collectability of an amount already included in revenue, the uncollectable amount, which no longer qualifies in terms of probability of collection, is provided for and recognised as an expense in the income statement.

Interest income

Interest income is recognised in the income statement for all interest-bearing instruments on an accrual basis using the effective interest method. In terms of the effective interest method, interest is recognised at a rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the carrying amount on the financial statements. Direct incremental transaction costs incurred and origination fees received as a result of bringing margin-yielding assets on balance sheet, are capitalised to the carrying amount of financial instruments (excluding financial instruments at fair value through profit or loss) and amortised as interest income over the life of the asset.

Where financial assets have been impaired, interest income continues to be recognised on the impaired value based on the original effective interest rate. Interest income includes fair value adjustments on interest-bearing financial instruments held at fair value, excluding financial instruments held for trading.

Fee income

Fee income comprises appraisal fees and administration fees and excludes vat. Fee income is recognised when earned.

Investment income

Investment income comprises realised and unrealised gains on investments, interest income and dividend income.

Interest income is accrued on a time basis, by reference to the principal outstanding and the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

1.16 Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

1.17 Management of financial and indemnity risks

The group's activities expose it to a variety of financial risks, including the effects of changes in debt and equity market prices and interest rates. The group's overall risk management pro gramme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the group.

Risk management is carried out primarily by a risk and compliance division supported by the finance division under policies approved by the Board of Directors. The divisions identify, evaluate and address financial risks in close co-operation with the group's operating units. The Board provides written policies covering specific areas, such as interest rate risk, credit risk, use of financial instruments, and investing excess liquidity.

Financial risk

The group is exposed to market risk, interest rate risk and liquidity risk arising from the financial instruments it holds. The risk management policies employed by the group to manage these risks are discussed below:

Market risk

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices. Fair value of investments is determined with reference to quoted market prices.

Interest rate risk

IInterest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

The group's income and operating cash flows are substantially dependent on changes in market interest rates and the group has significant interest-bearing assets. The group's policy is to maintain most of its investments in the form of money market instruments. Interest rate risk is limited to the group's investment in floating-rate instruments such as deposits, negotiable certificates of deposits and banker's acceptances. The investment management function has been outsourced to Andisa Capital (Proprietary) Limited, STANLIB Collective Investments Limited and Pan Africa Asset Management (Proprietary) Limited. Regular management and Board sub-committee meetings are held in order to review Khula Enterprise Finance Limited's interest rate view, which would affect the level of interest rate risk taken in respect of surplus funds.

Money market investments are reflected as cash and cash equivalents.

Credit risk

Credit risk is the risk that a counter-party to a financial instrument will fail to discharge an obligation and cause the group to incur a financial loss.

All credit risk arises from normal operations of the group, with the major credit risk arising from the group's receivables and business loans. The Investment Committee reviews the group's loan book on an on-going basis. All applications for credit are thoroughly scrutinised covering financial, technical and reputational risks. Khula Enterprise Finance, being a development finance institution, has a different risk profile compared to traditional commercial banks.

The second risk, which is considered to be low, is money market transaction risk. The funds are invested only with approved high credit quality financial and public sector institutions in accordance with predetermined limits approved by Executive Management and the Board.

Liquidity risk

Liquidity risk is the risk that the group will encounter difficulty in raising funds to meet commitments associated with financial instruments.

Due to the nature of the business, the group's cash management process aims to maintain flexibility in funding by keeping committed credit lines available. Cash requirements and inflows are monitored by management to ensure that sufficient cash is available to meet all financial commitments including operational expenditure.

Operational risk

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events.

The initiation of all transactions and their administration is conducted on the foundation of segregation of duties that has been designed to ensure materially the completeness, accuracy and validity of all transactions and the safeguarding of assets. These controls are augmented by management and executive review of control accounts and systems, manual checks and controls, back-up facilities and contingency planning. The internal control systems and procedures are also subjected to regular internal audit reviews.

Legal risk

Legal risk is the risk that the group will be exposed to unnecessary or onerous contractual obligations. During the development stage of any new product and for any corporate transaction the legal resources of the group are required to monitor the drafting of contract documentation to ensure that rights and obligations of all parties are clearly set out.

Tax risk

Tax risk is the risk that the group will incur a financial loss due to an incorrect interpretation and application of the tax legislation or due to the impact of new tax legislation on existing structures.

During the development stage of any new product and prior to any corporate transactions, the legal resources of the group and the group's tax advisors and, if required, external resources are utilised to identify and advise on any material potential tax impact thereof.

Indemnity risk

The group issues indemnity contracts that transfer insurance risk. The Board and executive committee manage the indemnity risk according to the group's risk appetite.

The risk under any one indemnity contract is the likelihood that the indemnified event will occur, and the uncertainty of the amount of the resulting claims. For a portfolio of indemnity contracts where the theory of probability is applied to provisioning, the principle risk that the group faces is that the actual claims and benefit payments exceed the carrying amount of the indemnity liabilities. By the very nature of an indemnity contract, the risk is random and therefore unpredictable. Changing risk parameters and unforeseen factors, such as economical and geographical circumstances, may result in unexpectedly large claims. Indemnified events are random and from one year to the next the actual number of claims will vary from the estimate established by means of statistical techniques.

The net claims ratio for the group, which is important in monitoring indemnity risk, has developed as follows over the past 4 years:

Loss history	**2006/7**	**2005/6**	**2004/5**	**2003/4**
Claims paid and provided %*	146%	206%	96%	61%

*Expressed as a percentage of net earned fees

Factors that aggravate indemnity risk include lack of risk diversification in terms of type and amount of risk and geographical location covered. Experience shows that the larger the portfolio of similar indemnity contracts, the smaller the relative variability about the expected outcome will be, therefore a more diversified portfolio is less likely to be affected across the board by a change in any subset of the portfolio. The group only underwrites indemnity contracts in South Africa.

The group does not have the right to re-price and change the conditional risks on renewal of individual indemnities.

The group establishes a provision for claims using independent actuarial methods. Claim provisions are regularly checked by way of internal reviews and audits to ensure they are sufficient. These analyses draw on the expertise and experience of a wide range of specialists, such as actuaries, auditing and accounting experts

Limiting exposure to indemnity risk

The group limits its exposure to indemnity risk through setting a clearly defined underwriting strategy and limits and adopting appropriate risk assessment techniques. Each of these risk management aspects is dealt with below in more detail.

(1) Underwriting strategy and limits and policies for mitigating indemnity risk

The group's underwriting strategy seeks diversity to ensure a balanced portfolio of indemnity risks. The strategy also aims to establish a sufficiently large portfolio to reduce the variability of the outcome. To this end the group underwrites a wide variety of risks spread across financial and commercial indemnity holders, which includes the underwriting of risks in niche markets with favourable claims expectations.

On an annual basis the group prepares an underwriting budget that is based on the underwriting strategy to be followed in the next 3 years. The underwriting strategy is updated for changes in the underwriting results of the group and the industry, the group's available risk capital, its developmental mandate as well as existing concentrations of indemnity risk.

(II) Risk assessment

The group relies on a rigorous process being followed by the indemnified parties before they propose and accept a specific indemnity risk. Some of the factors considered during the underwriting stage include:

- past loss experience associated with the proposed risk;
- indemnifiable interest;
- probability of success;
- level of mitigation procedures adopted by the proposed indemnified;
- location of the proposed risk;
- past and proposed rating terms of the risk;
- scope and terms of cover considered;
- results of surveys completed, where applicable; and
- possible variations that may be applied to the risks indemnified.

Concentration of indemnity risks

The group's insurance portfolio consists of indemnity risks. The concentration of indemnity risks is managed by different levels of diversification mainly through the financial institutions that are underwritten and the geographical areas in which the risks are situated, with single risks spread across all areas of the country.

1.18 Critical accounting estimates and judgements

Critical accounting estimates are those that involve complex or subjective judgements or assessments. The areas of the Company's business that typically requires such estimates are the determination of fair value for financial assets, financial liabilities and investment properties, the impairment charges on financial instruments, loans and advances and deferred taxes.

The fair values of financial assets and liabilities are classified and accounted for in accordance with the policies set out in section 1.3 above. The impairment of tangible, intangible and other assets are dealt with in detail in sections 1.4 and 1.6 above.

1.19 Standards and interpretations applicable to the group not yet effective

IFRS 7 Financial Instruments: Disclosures (including amendments to IAS 1, Presentation of Financial Statements: Capital Disclosures, effective for all annual periods commencing on or after 1 January 2007. IFRS 7 and the amendments to IAS 1 deal mainly with the disclosure of financial instruments, the related qualitative and quantitative risks associated with financial instruments and objectives, processes and policies for managing capital. To a large extent these disclosure requirements were previously covered in terms of IAS 30 and IAS 32. The standard and amendments will therefore not impact the results of the group but will result in increased disclosure relating to financial instruments in particular.

IFRS 8 Operating segments, effective for all annual periods commencing on or after 1 January 2009. IFRS 8 replaces IAS 14 Segment Reporting and aligns segment reporting with the requirements of SFAS 131 (US standard). This standard requires an entity to adopt the 'management approach' when reporting on the financial performance of its operating segments. The reporting will be based on the information that management uses internally for evaluating segment performance and when deciding how to allocate resources to operating segments. The statement will not impact the results of the group and will not impact the format of disclosure and measurement of the results of reportable segments.

IFRIC 9 Reassessment of Embedded Derivatives, effective for all annual periods commencing on or after 1 June 2006. This interpretation states that an embedded derivative should be assessed for separation from the host contract when the entity first becomes a party to the contract. The entity may only make a subsequent reassessment if there is a significant change in the terms of the contract (i.e. in the terms of the host contract, the embedded derivative or both). A significant change in the terms of a contract is defined as a significant change in the expected future cash flows arising from the hybrid instrument before and after the modification. This interpretation is not expected to impact the results of the group significantly.

2. Office Equipment, Furniture and other Tangible Assets

	Group & Company		
	Cost R	Accumulated Depreciation	Carrying Value R
2007			
Motor vehicle	300,189	33,461	266,728
Computer equipment	9,342,261	7,754,068	1,588,193
Office equipment	483,489	432,764	50,725
Furniture and fittings	1,727,926	1,558,562	169,364
	11,853,865	9,778,855	2,075,010
2006			
Motor vehicle	64,443	26,850	37,593
Computer equipment	8,549,710	6,997,607	1,552,103
Office equipment	478,039	398,901	79,138
Furniture and fittings	1,631,878	1,480,052	151,826
	10,724,070	8,903,410	1,820,660

2. Office Equipment, Furniture and other Tangible Assets (continued)

The movement in the carrying value of office equipment, furniture and other tangible assets is as follows:

	Motor vehicle	Computer equipment	Office equipment	Furniture and fittings	Total
2007	R	R	R	R	R
Carrying value at 1 April 2006	**37,593**	**1,552,103**	**79,138**	**151,826**	**1,820,660**
Additions	**300,189**	**1,074,861**	**5,450**	**96,048**	**1,476,548**
Disposals	**(32,222)**	**-**	**-**	**-**	**(32,222)**
Depreciation charge	**(38,832)**	**(1,038,771)**	**(33,863)**	**(78,510)**	**(1,189,976)**
Carrying value at 31 March 2007	**266,728**	**1,588,193**	**50,725**	**169,364**	**2,075,010**
2006					
Carrying value at 1 April 2005	50,482	1,831,639	113,602	245,871	2,241,594
Additions	-	877,919	-	-	877,919
Disposals	-	(33,908)	-	-	(33,908)
Depreciation charge	(12,889)	(1,123,547)	(34,464)	(94,045)	(1,264,945)
Carrying value at 31 March 2006	37,593	1,552,103	79,138	151,826	1,820,660

3. Loans And Advances

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
Originated advances:				
Business loans	**158,303,946**	137,320,063	**158,303,946**	137,320,063
Property sale loans	**3,945,391**	2,104,823	**3,945,391**	2,104,823
	162,249,337	139,424,886	**162,249,337**	139,424,886
Credit impairments for loans and advances	**(13,730,950)**	(2,536,892)	**(13,730,950)**	(2,536,892)
	148,518,387	136,887,994	**148,518,387**	136,887,994

Property sale loans are provided to facilitate the acquisition of investment properties. Transfer of the property only takes place once the loan has been repaid in full. The loans are priced at market related interest rates and carried at fair value.

Maturity analysis of business loans and property sale loans

2007	**-**	2,685,081	**-**	2,685,081
2008	**6,460,195**	19,529,335	**6,460,195**	19,529,335
2009	**10,564,551**	24,285,651	**10,564,551**	24,285,651
2010	**26,863,039**	31,007,918	**26,863,039**	31,007,918
2011	**51,940,320**	51,847,035	**51,940,320**	51,847,035
2012	**36,641,909**	10,069,866	**36,641,909**	10,069,866
After 2012	**29,779,323**	-	**29,779,323**	-
	162,249,337	139,424,886	**162,249,337**	139,424,886

3. Loans and Advances (continued)

Credit impairments for loans and advances

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
Balance at beginning of the year	**(2,536,892)**	(7,081,534)	**(2,536,892)**	(7,081,534)
Credit losses written off	**-**	7,329,628	**-**	7,329,628
Credit impairments raised in income	**(11,194,058)**	(2,883,421)	**(11,194,058)**	(2,883,421)
Credit impairments released in income	**-**	98,435	**-**	98,435
Balance at end of the year	**(13,730,950)**	(2,536,892)	**(13,730,950)**	(2,536,892)
Recoveries on loans and advances previously written off	**608,941**	359,971	**608,941**	359,971

4. Related Party Loans

Khula Institutional Support Services**	**6,863,365**	(802,158)	**6,863,365**	(802,158)
Khula Land Reform Empowerment Facility**	**766,218**	1,775,455	**766,218**	1,775,455
	7,629,583	973,297	**7,629,583**	973,297

** Registered as a "section 21" not for gain company

5. Investment Properties

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
Carrying value at beginning of year	**142,811,779**	137,728,288	**142,811,779**	137,728,288
Additions	**521,920**	2,776,837	**521,920**	2,776,837
Disposals	**(10,029,589)**	(6,214,857)	**(10,029,589)**	(6,214,857)
Fair value adjustment	**18,193,895**	8,521,511	**18,193,895**	8,521,511
	151,498,005	142,811,779	**151,498,005**	142,811,779

Investment properties are valued annually at fair value. All investment properties were valued on 28 February 2007, by Magau Property Valuers CC. Details of the investment properties are held at the registered office of Business Partners Limited, the administrators of the properties. Investment properties are not mortgaged as security for any liabilities and are free of any encumbrances.

6. Investments

Investments held at fair value through profit and loss

Fair value				
– Listed shares	**43,802,808**	73,969,962	**43,802,808**	73,969,962
Amortised cost	**129,436,870**	101,372,954	**115,672,353**	92,254,866
– Unlisted shares	**99,432,675**	96,269,993	**90,333,167**	90,587,030
– Share of En Commandite partnership	**25,339,186**	1,667,836	**25,339,186**	1,667,836
– Unlisted shares – private equity	**13,349,933**	17,658,137	**-**	-
– Provision against private equity	**(8,684,924)**	(14,223,012)	**-**	-
	173,239,678	175,342,916	**159,475,161**	166,224,828

Listed shares are fair valued annually at the close of business on 31 March. For investments traded in active markets, fair value is determined by reference to Stock Exchange quoted bid prices. For other investments, fair value is determined or estimated by reference to the current market value of similar instruments or by reference to the discounted cash flows of the underlying net assets. The listed shares registered an unrealised gain of R13,219,843 (2006: R6,215,107) in both the group and company.Investments held at fair value through profit and loss are classified as non-current assets, unless they are expected to be realised within twelve months of the balance sheet date or unless they need to be sold to raise operating capital.

7. Investment in Associate

	Group		Company	
	2007	2006	**2007**	**2006**
	R	R	**R**	**R**
40% Unlisted share in The Enablis Khula Loan Fund at cost	**8,000,000**	2,000,000	**8,000,000**	2,000,000
Share of retained earnings	**-**	59,057		
	8,000,000	2,059,057	**8,000,000**	2,000,000
Directors' valuation	**8,000,000**	2,059,057	**8,000,000**	2,000,000
The movement in investment in associate is as follows:				
At the beginning of year	**2,059,057**	1,311,210	**2,000,000**	1,311,210
Investment made	**6,000,000**	688,790	**6,000,000**	688,790
Share of results before tax	**(98,429)**	98,429		
Share of tax	**39,372**	(39,372)		
At end of year	**8,000,000**	2,059,057	**8,000,000**	2,000,000

The group and company's proportionate interest in net assets of the associate is as follows:

Trade and other receivables	470,983
Cash and cash equivalents	7,799,635
	8,270,618
Accounts payable	270,618
Equity	8,000,000
	8,270,618

The group and company's proportionate interest in income and expenses of the associate is as follows:

Revenue	270,834
Expenses	(369,263)
Loss before tax	(98,429)
Tax	39,372
Net loss for the year	(59,057)

Audited financial statements are used to determine the share of the associated company's earnings.

8. Investments in Subsidiaries and Joint Venture

	Company	
	2007	2006
	R	R
Subsidiaries		
Unlisted investments		
– Shares at cost	55,000,300	55,000,300
Loans owing by subsidiaries	9,156,330	9,460,606
New Cape Equity Fund (Proprietary) Limited	4,555,744	8,098,274
Khula Credit Guarantee Limited	2,100,586	1,362,332
The Khula-Enablis SME Acceleration Fund	2,500,000	-
Loans owing to subsidiaries	(200)	(200)
Khula Business Premises (Proprietary) Limited	(100)	(100)
MKN Equity Fund (Proprietary) Limited	(100)	(100)
	64,156,430	64,460,706
Joint venture		
Unlisted investment		
– Shares at cost	50	50
Loan owing by joint venture		
– Anglo Khula Mining Fund (Pty) Ltd	8,260,000	8,260,000
– Impairment provision against loan	-	(2,373,300)
	8,260,050	5,886,750
	72,416,480	70,347,456
Valuation		
– Unlisted investments at directors' valuation	72,416,480	70,347,456

8. Investments in Subsidiaries and Joint Venture (continued)

Information on subsidiaries and joint venture

	Nature of activities	Issued Capital	
		2007	2006
		R	R
Subsidiaries			
Khula Credit Guarantee Ltd	Short term indemnities	**42,166,676**	42,166,676
New Cape Equity Fund (Pty) Ltd	Private equity funding	**100**	100
MKN Equity Fund (Pty) Ltd	Private equity funding	**100**	100
Khula Business Premises (Pty) Ltd	Property rental	**100**	100
The Khula-Enablis SME Acceleration Fund	SME Financing	**-**	-

All subsidiaries, except The Khula-Enablis SME Acceleration Fund in which the company holds 80%, are wholly owned and companies incorporated in South Africa. All holdings are in the ordinary share capital of the entity concerned and are unchanged from 2006.

	Nature of activities	Company	
		2007	2006
		R	R
Joint venture			
Anglo Khula Mining Fund (Pty) Ltd	*Joint venture finance of mining activities with Anglo American Plc*	**100**	100

The joint venture company is incorporated in South Africa and the shareholding of 50% of the joint venture is unchanged from 2006.

9. Deferred Tax

Deferred income taxes are calculated in full on temporary differences under the liability method using a principal tax rate of 29% (2006: 29%). Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The movement on the net deferred income tax account is as follows:

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
At beginning of the year	**9,293,698**	6,172,459	**(475,254)**	5,535,510
Income statement charge				
– Temporary differences	**(1,851,132)**	(2,098,867)	**(5,296,991)**	(4,008,546)
– Prior year underprovision	**-**	5,220,106	**-**	(2,002,218)
At end of the year	**7,442,566**	9,293,698	**(5,772,245)**	(475,254)
The balance comprises:				
Deferred tax asset	**24,803,122**	18,342,340	**10,461,303**	8,573,388
Income received in advance	**513,693**	102,721	**-**	-
Rental deposits	**-**	778,955	**-**	778,955
Fair value adjustments	**778,421**	634,916	**625,835**	625,835
Assessed loss	**-**	2,665,231	**-**	-
Other provisions	**23,511,008**	14,160,517	**9,835,468**	7,168,598
Deferred tax liability	**(17,360,556)**	(9,048,642)	**(16,233,548)**	(9,048,642)
Prepaid expenses	**-**	(427,457)	**-**	(427,457)
Capital loss not recognised	**(625,835)**	(625,835)	**(625,835)**	(625,835)
Debtor allowances	**(1,938,932)**	(1,519,676)	**(1,938,932)**	(1,519,676)
Fair value adjustments	**(14,795,789)**	(6,475,674)	**(13,668,781)**	(6,475,674)
	7,442,566	9,293,698	**(5,772,245)**	(475,254)

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
10. Share Capital				
Authorised				
500,000,000 ordinary shares at R1 each	**500,000,000**	500,000,000	**500,000,000**	500,000,000
Issued				
308,300,000 ordinary shares at R1 each	**308,300,000**	308,300,000	**308,300,000**	308,300,000
11. Shareholders' Loan				
Loan from shareholder	**540,381,131**	540,381,131	**540,381,131**	540,381,131
12. Indemnity Reserves				
Unexpired risk reserve				
– At beginning of year	**37,700,000**	38,684,211	**-**	-
– Movement recorded in income	**12,772,000**	(984,211)	**-**	-
At end of the year	**50,472,000**	37,700,000	**-**	-

The loan is unsecured, bears no interest and does not have fixed repayment terms.

Provision for unearned fees

An unearned premium risk reserve (UPR) has not been raised since the unexpired risk reserve is adequate as determined by actuarial valuation, and is not considered necessary since Khula Credit Guarantee Limited does not price its fees for the associated risks.

12. Indemnity Reserves (continued)

Short-term indemnity contracts – assumptions, change in assumptions and sensitivity

(i) Process used to decide on assumptions

The indemnity reserve is calculated as an Unexpired Risk Reserve. The Unexpired Risk Reserve is the total amount of reserves set aside to meet claims arising from the unexpired risk on contracts in force on 31 March 2007. The Unexpired Risk Reserve equals the sum of the Unearned Premium Reserve and the Additional Unexpired Risk Reserve. The Additional Unexpired Risk Reserve is raised since it is expected that the Unearned Premium Reserve will be insufficient to cover the claims arising from the unexpired risk on contracts in force on 31 March 2007.

Unexpired Risk Reserve

Both the claim frequency and the claim severity experienced to date are modelled statistically. During this process the impact of different factors on the models is tested statistically. The most significant factors that appear to have an impact on the claims experience are considered. In estimating the total future claims cost a best estimate prediction interval in the model is used. Thus the estimated claim reserves are expected to be sufficient to meet the future total claims cost arising from those contracts with a probability of 95 percent. The gearing ratio and the expected future claims cost, expressed as a proportion of the total indemnity amount, for all active contracts as at 31 March 2007 is then calculated. An allowance for the future claims handling expenses of Khula in respect of these contracts is also provided for.

Unearned Premium Reserve

The exposure to risk under the contracts falls into more than one accounting period. A proportion of the premiums received in a given financial year are reserved to meet the liability arising from the exposure after the accounting year-end. This exposure has already been contracted and paid for by the premium received. Khula has performed the calculation of an Unearned Premium Reserve for those contracts in force as at 31 March 2007 using the 365ths method. This method takes account of the day of inception. Thus the Unearned Premium Reserve for an annual contract written on the mth day of the accounting period is: $(365 - m)/365 \times P$, where P is the annual gross premium.

12. Indemnity Reserves (continued)

(ii) Change in assumptions

There has been no change in assumptions over the past year.

(iii) Sensitivity analysis

The inherent nature of the process described above is to produce a distribution of ultimate claims costs. By holding reserves that are at least sufficient at the best estimate of this distribution, Khula ensures that its reserves are adequate.

(iv) Claims development tables

The presentation of the claims development tables for the group, is based on the actual date of the event that caused the claim. The claims development tables represent the development of actual claims paid.

Claims paid in respect of:

	2007 R	2006 R	2005 R	2004 R
Conventional short-term indemnities – gross and net				
Actual claim costs:				
- 2007	**16,038,507**			
- 2006	**3,708,400**	12,591,591		
- 2005	**122,016**	4,740,559	200,000	
- 2004	**-**	1,308,506	572,000	1,333,000
- Before 2004	**-**	324,545	13,372,000	26,859,000
Cumulative payments to date	**19,868,923**	18,965,201	14,144,000	28,192,000
Less: Salvages and legal fees recovered	**(4,011,313)**	(2,645,564)	(2,878,326)	(3,978,693)
	15,857,610	16,319,637	11,265,674	24,213,307

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
13. Claims Provision				
At beginning of year	**35,200,000**	27,017,544	**-**	-
Movement recorded in income	**3,907,000**	8,182,456	**-**	-
At end of year	**39,107,000**	35,200,000	**-**	-
14. Other Provisions				
Opening balance	**4,074,977**	3,566,126	**3,808,525**	3,416,091
Provision raised	**5,055,772**	3,171,926	**5,055,772**	2,948,450
Utilisation of provision	**(3,546,989)**	(2,663,075)	**(3,280,537)**	(2,556,016)
Closing balance	**5,583,760**	4,074,977	**5,583,760**	3,808,525
15. Investment Property Rental Income				
Rentals	**30,589,238**	29,122,551	**30,589,238**	29,122,551
Recovery of property expenses	**7,159,903**	7,690,405	**7,159,903**	7,690,405
	37,749,141	36,812,956	**37,749,141**	36,812,956

16. Other Income

	Group		Company	
	2007 R	2006 R	2007 R	2006 R
Bad debts recovered	1,136,533	842,586	999,890	842,586
Management fee				
- Subsidiaries			5,921,332	1,147,983
- Related parties	3,451,966	4,242,667	3,451,966	4,242,667
Other investment property income	428,497	408,885	428,497	408,885
Other sundry income	1,994,089	3,429,533	1,367,446	1,596,350
Penalty interest earned on rentals	705,040	621,475	705,040	621,475
Profit on sale of investment properties	2,431,544	1,953,975	2,431,544	1,953,975
Profit on sale of office equipment, furniture and other intangibles	56,008	-	56,008	-
	10,203,677	11,499,121	15,361,723	10,813,921

17. Investment Income

Dividend income	11,961,949	10,541,861	10,207,965	9,583,149
Interest income	48,886,159	41,958,753	37,845,780	32,493,704
	60,848,108	52,500,614	48,053,745	42,076,853

	Group		Company	
	2007	2006	2007	2006
	R	R	R	R
18. Net Fair Value Gain On Financial and Other Assets				
Investments	20,712,202	6,309,297	12,686,887	6,265,848
Investment properties	18,193,895	8,521,511	18,193,895	8,521,511
	38,906,097	14,830,808	30,880,782	14,787,359
19. Staff Costs				
Salaries	10,280,865	8,324,883	10,280,865	7,744,830
Skills development levy	185,982	152,384	185,982	144,268
UIF	140,598	111,112	140,598	103,106
Provident fund costs	2,055,660	1,649,303	2,055,660	1,533,177
Other	10,831,128	7,205,033	10,831,128	6,731,750
	23,494,233	17,442,715	23,494,233	16,257,131
20. Investment Property Expenses				
Included in investment property expenses are:				
Bad debts written off	2,171,333	1,925,862	2,171,333	1,925,862
Repairs and maintenance expense	3,790,849	3,279,644	3,790,849	3,279,644
Management fee	8,165,098	8,274,498	8,165,098	8,274,498

21. Operating Profit

The following items have been included in arriving at operating profit:

	Group		Company	
	2007 R	2006 R	2007 R	2006 R
Auditors' remuneration	969,997	870,241	601,767	556,608
– Audit fees	936,671	838,949	601,767	556,608
– Expenses	33,326	31,292	-	-
Depreciation	1,189,976	1,264,945	1,189,976	1,264,945
– Motor vehicles	38,832	12,889	38,832	12,889
– Computer equipment & software	1,038,771	1,123,547	1,038,771	1,123,547
– Office equipment	33,863	34,464	33,863	34,464
– Furniture and fittings	78,510	94,045	78,510	94,045
Directors' emoluments	2,186,596	2,290,854	2,186,596	2,290,854
– Executive director	1,941,596	1,841,973	1,941,596	1,841,973
– Non-executive directors	245,000	448,881	245,000	448,881

21. Operating Profit (Continued)

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
Professional fees	**3,726,406**	2,989,687	**3,223,973**	2,644,688
– Consultancy	**2,981,134**	2,011,751	**2,610,408**	1,859,428
– Treasury management	**745,272**	977,936	**613,565**	785,260
Indemnity claims incurred	**15,857,610**	16,319,637	**-**	-
Impairment of private equity investments	**2,419,206**	2,040,867	**-**	-
Impairment of joint venture			**(2,373,300)**	2,373,300
Impairment charge for bad and doubtful debts	**11,194,058**	2,784,986	**11,194,058**	2,784,986
Increase in claims provision	**3,907,000**	8,182,456	**-**	-
Increase/(Decrease) in indemnity reserves	**12,772,000**	(984,211)	**-**	-
Loss on sale of office equipment, furniture and other intangibles	**-**	33,908	**-**	33,908
Loss on sale of listed shares in respect of the participation of Khula in a BEE transaction	**7,140,260**	-	**7,140,260**	-
Operating lease charges	**4,708,420**	3,592,745	**4,708,420**	3,592,745
– Equipment	**489,589**	44,998	**489,589**	44,998
– Property	**4,218,831**	3,547,747	**4,218,831**	3,547,747

22. Tax

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
SA normal tax				
Current year	**5,368,807**	2,236,543	**5,368,807**	2,236,543
– Prior year under provision	**-**	7,353,405	**-**	131,080
	5,368,807	9,589,948	**5,368,807**	2,367,623
Deferred taxation	**1,851,132**	(3,121,239)	**5,296,991**	6,010,764
Current year	**1,851,132**	(2,098,867)	**5,296,991**	4,008,547
Prior year	**-**	(5,220,106)	**-**	2,002,217
	7,219,939	6,468,709	**10,665,798**	8,378,387

The tax on the group's profit before tax differs from the theoretical amount that would arise using the South African tax rate as follows:

SA standard tax rate	**29%**	29%	**29%**	29%
Permanent differences	**(12.2%)**	(11.5%)	**(8.0%)**	(9.3%)
Capital gains tax	**2.1%**	1.0%	**1.7%**	0.8%
Deferred tax – fair value losses	**-**	(3.2%)	**-**	(2.6%)
Deferred tax – prior year	**-**	(18.2%)	**-**	5.7%
Normal tax – prior year	**-**	25.8%	**-**	0.4%
Tax - associate	**(0.0%)**	(0.2%)	**-**	-
Effective rate	**18.9%**	22.7%	**22.7%**	24.0%

23. Reconciliation of Net Profit for the Year to Cash Utilised by Operations

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
Profit before tax	**38,242,705**	28,469,393	**47,069,560**	34,980,737
Adjustments for:				
Depreciation	**1,189,976**	1,264,945	**1,189,976**	1,264,945
Fair value adjustments	**(38,906,097)**	(14,830,808)	**(30,880,782)**	(14,787,359)
Fair value adjustment – money market instruments	**(1,059,116)**	94,190	**(532,956)**	50,741
Impairment provision – unlisted shares	**2,419,206**	2,040,867	**-**	-
Impairment provision – joint venture			**(2,373,300)**	2,373,300
Income from associate company	**59,057**	(59,057)		
Increase/(Decrease) in indemnity reserves	**12,772,000**	(984,211)	**-**	-
Investment income	**(60,848,108)**	(52,500,614)	**(48,053,745)**	(42,076,853)
Loss on sale of listed investment	**7,140,260**	-	**7,140,260**	-
Profit on sale of investment properties	**(2,431,544)**	(1,953,975)	**(2,431,544)**	(1,953,975)
(Profit)/Loss on sale of equipment	**(56,008)**	33,908	**(56,008)**	33,908
Provision for bad debts	**11,194,058**	2,784,986	**11,194,058**	2,784,986
Provision for claims	**3,907,000**	8,182,456	**-**	-
Operating loss before changes in working capital	**(26,376,611)**	(27,457,920)	**(17,734,481)**	(17,329,570)
Changes in working capital	**4,969,404**	(836,842)	**5,413,520**	(871,543)
Decrease/(Increase) in trade and other receivables	**1,521,376**	940,163	**2,598,324**	(826,881)
Increase/(Decrease) in trade and other payables and provisions	**3,448,028**	(1,777,005)	**2,815,196**	(44,662)
Cash utilised by operations	**(21,407,207)**	(28,294,762)	**(12,320,961)**	(18,201,113)

24. Tax Paid

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
Tax payable at the beginning of the year	**5,493,529**	4,167,513	**804,698**	6,701,007
Tax as per income statement (net of deferred tax)	**5,368,807**	9,589,948	**5,368,807**	2,367,623
Tax payable at the end of the year	**(9,623,244)**	(5,493,529)	**(4,934,413)**	(804,698)
	1,239,092	8,263,932	**1,239,092**	8,263,932

25. Cash and Cash Equivalents

Cash in bank and on hand	**23,057,585**	60,390,822	**14,153,709**	54,065,211
Short-term money market instruments	**638,372,973**	573,452,679	**505,806,674**	443,197,796
	661,430,558	633,843,501	**519,960,383**	497,263,007

The money market instruments registered a fair value loss of R1,059,116 (2006 gain: R94,190) in the group and a R532,956 loss (2006 gain: R50,741) in the company. The remaining term of all money market instruments is less than 12 months.

26. Contingent Liabilities

Indemnities issued to financial institutions	**460,322,000**	389,099,354	**-**	-

27. Commitments

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
Business loan facilities approved but not taken up	**285,300,000**	52,053,746	**285,300,000**	52,053,746
Equity funds, subsidiary and joint venture loans approved, not taken up	**167,984,944**	156,028,394	**167,984,944**	156,028,394
Indemnities approved but not extended	**13,476,679**	7,622,108	**-**	-
	466,761,623	215,704,248	**453,284,944**	208,082,140

Operating lease commitments

The future minimum lease payments under non-cancellable operating leases are as follows:

Equipment	**678,078**	828,833	**678,078**	828,833
Within 1 year	**197,001**	238,880	**197,001**	238,880
From 2 to 5 years	**481,077**	589,953	**481,077**	589,953
Building	**60,433,308**	62,549,059	**60,433,308**	62,549,059
Within 1 year	**2,802,101**	2,253,853	**2,802,101**	2,253,853
From 2 to 5 years	**13,152,057**	12,207,833	**13,152,057**	12,207,833
More than 5 years	**44,479,150**	48,087,373	**44,479,150**	48,087,373
	61,111,386	63,372,892	**61,111,386**	63,372,892

The lease agreement for the building stipulates that there will be an escalation of 6,5% per year. The lease agreement is for 15 years and will expire on 15 March 2021. There is no option to buy the building after the lease period has expired. The lease is for the use of the building, computer room, store rooms and parking. None of the property is sublet.

28. Related Party Transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated in the group financial statements, however these are not eliminated in the individual company financial statements.

Trading transactions

During the year, group companies entered into the following transactions with related parties who are not members of the group:

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
Khula Institutional Support Services	**2,738,150**	2,742,443	**2,738,150**	2,742,443
Khula Land Reform Empowerment Facility	**713,816**	1,500,224	**713,816**	1,500,224
	3,451,966	4,242,667	**3,451,966**	4,242,667

Any outstanding amounts are unsecured and will be settled in cash. No guarantees have been given or received. No expenses have been recognised in the period for bad or doubtful debts in respect of the amounts owed by related parties.

	Group		Company	
	2007	2006	**2007**	2006
	R	R	**R**	R
Executive management remuneration				
Basic	**2,421,625**	3,570,250	**2,421,625**	3,570,250
Performance bonuses	**611,491**	1,160,972	**611,491**	1,160,972
	3,033,116	4,731,222	**3,033,116**	4,731,222

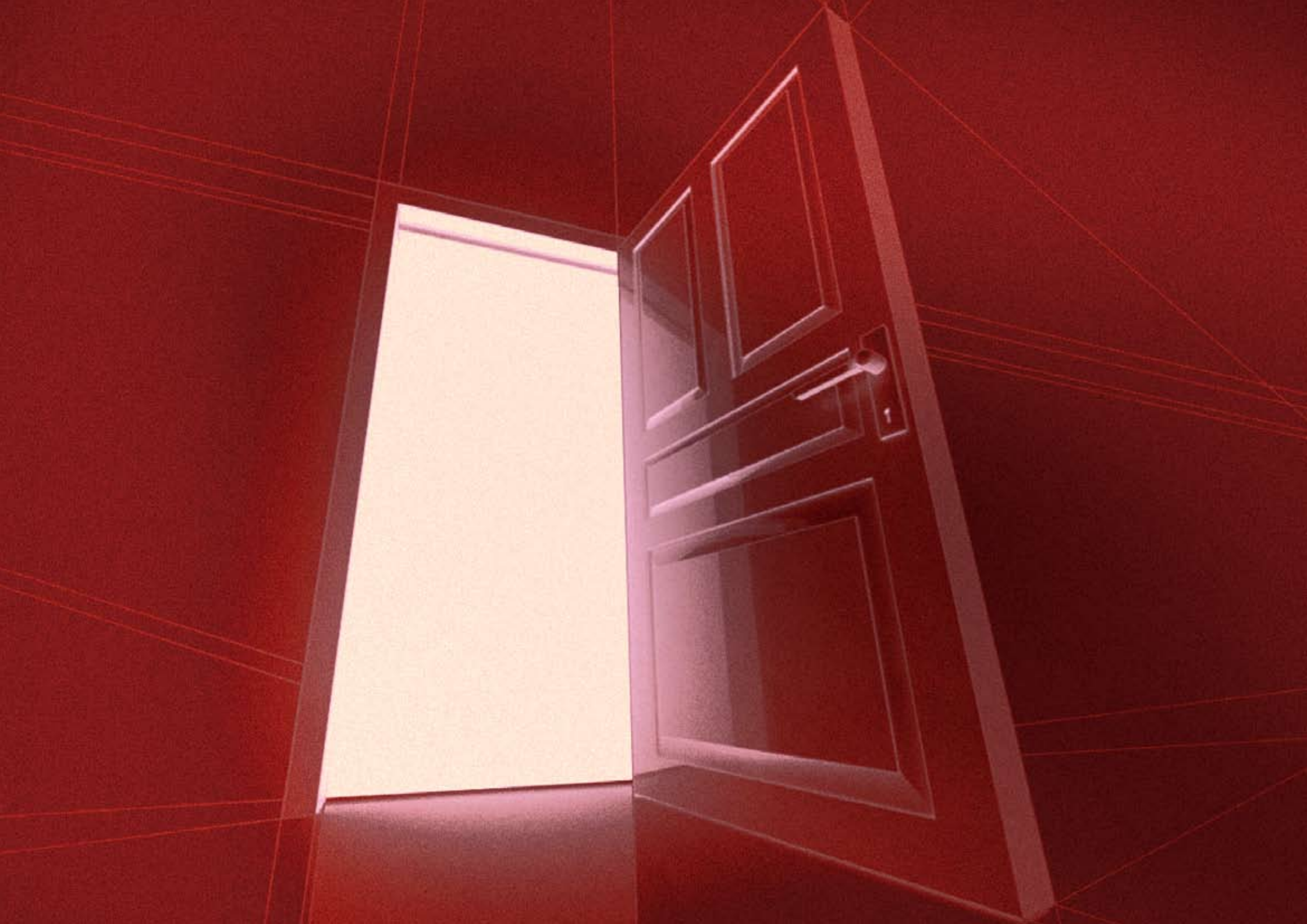
29. Interest in Joint Venture

The financial statements of the joint venture for the year ended 31 March 2007, which represents 50% interest in the profits of Anglo Khula Mining Fund (Proprietary) Limited, are incorporated in the consolidated financial statements. The group's proportionate interest in the assets and liabilities, which are included in the consolidated financial statements are as follows:

	Group	
	2007	2006
	R	R
The group's proportionate interest in net assets of the joint venture is as follows:		
Unlisted shares – at valuation (2006 cost)	**4,145,175**	5,682,963
Loans to joint venture	**4,954,333**	-
Trade and other receivables	**834,419**	2,500
Cash and cash equivalents	**6,320,022**	748,169
	16,253,949	6,433,632
Loans from investors – non interest bearing	**8,260,000**	8,260,000
Non-current liabilities – non interest bearing	**406,619**	406,619
Trade and other payables	**183,976**	140,313
Deferred tax	**1,127,007**	-
Interest in equity	**6,276,347**	(2,373,300)
	16,253,949	6,433,632
The group's proportionate interest in income and expenses of the joint venture is as follows:		
Revenue	**10,816,132**	548,413
Expenses	**(1,039,477)**	(1,854,949)
Net profit/(loss) for the year	**9,776,655**	(1,306,536)
The group's proportionate interest in cash flow of the joint venture:		
Operating activities	**(1,777)**	(1,169,343)
Investing activities	**5,573.631**	(859,722)
Financing activities	**-**	2,200,000

30. Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.





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