REPORT OF THE CHIEF FINANCIAL OFFICER

Mr Andrew Wright
Chief Financial Officer

Finance Report

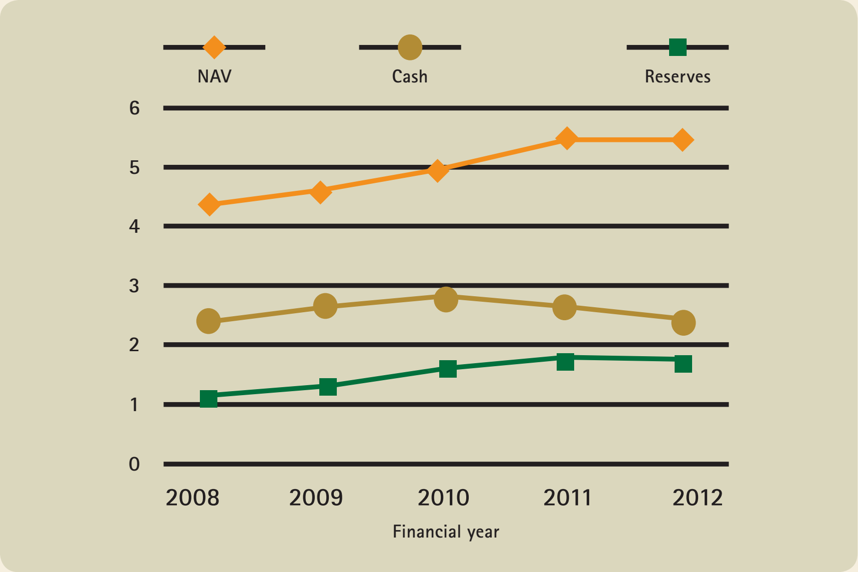
The investment approval and disbursement activity reported by the NEF in this annual report for the financial year under review has set the scene for unprecedented growth of the portfolio.

The value of investment approvals has grown by 55% year on year. The disbursements following on from this ramp-up in approvals will certainly once again demonstrate the NEF's ability to operate at a level of a major public entity in the development finance sector of South Africa.

Coupled with the growth in investment approvals, the highest level of facility drawdowns has also been reported in the year under review, represented by Investment Disbursements of R596 million (2011: R377 million) in the Cash Flow Statement of the annual financial statements.

In presenting this finance report, it is important to closely consider this significant growth in the portfolio against the strength of the Statement of Financial Position and the future sustainability of the mandated investment activities of the NEF. This will include the capital requirements of the NEF to meet future sustainability in order to be enabled to present a case to stakeholders detailing the NEF's ability to maintain this momentum in mandated investment activity.

Figure 1: Headline Values



Strength of the Statement of Financial Position

The net asset value of the Statement of Financial Position is currently reported at R5.3 billion as indicated in Figure 1. This is largely consistent with last year. Cash balances remain strong, though on the decline in accordance with the increase in disbursements reported this year. Reserves have shown a slight decline from last year, led by the decrease in fair value of listed state allocated investments, but they remain firm. Overall, in the light of these key indicators, the statement reveals NEF's financial position as remaining stable in respect of past investment activity and investment activity over the financial year under review.

> *"We want black people to go beyond being portfolio holders of 3% shares in this company, and 5% in that company. We want to see factories that are owned by black entrepreneurs."*
>
> President Jacob Zuma, Addressing BMF Annual Corporate Update, 06 July 2012.

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Sustainability of the portfolio of investments

The overall reported income before fair value movements, excluding dividends received, is a key indicator of the operational sustainability of the fund. At R67 million for 2012 (2011: R103 million) this represents a net return of -1% on the loans portfolio (2011: 3%). This indicator accounts for the ability of the cash and loans portfolio to sustain the operational overheads of the NEF. The progression into a negative return for the year is driven by two significant factors: the increases in overheads that the fund has incurred in its growth strategy, which included the roll-out into the regional provincial offices; and the impact of a budgeted increase in the REPO rate over the financial year, which did not materialise, resulting in a lower than budgeted return on the interest bearing portfolio.

This indicator will need to be brought back into a positive value in the current year through close cost management associated with continued reduction and containment of the impairment of new loans and careful consideration of the economic and interest rate outlook and its impact on the NEF's interest bearing portfolio.

Overheads have been well managed within budget for both this and previous financial years. They are not expected to grow at the same rate in the current financial year, since the investment in growth has now largely been completed and it should begin to yield benefits through steady growth in the portfolio. Disbursements into high quality transactions sourced by the provincial offices should not only yield fair returns with nominal impairments, but also deliver on the Empowerment Dividend impact reported on in the Trustees Report on Performance.

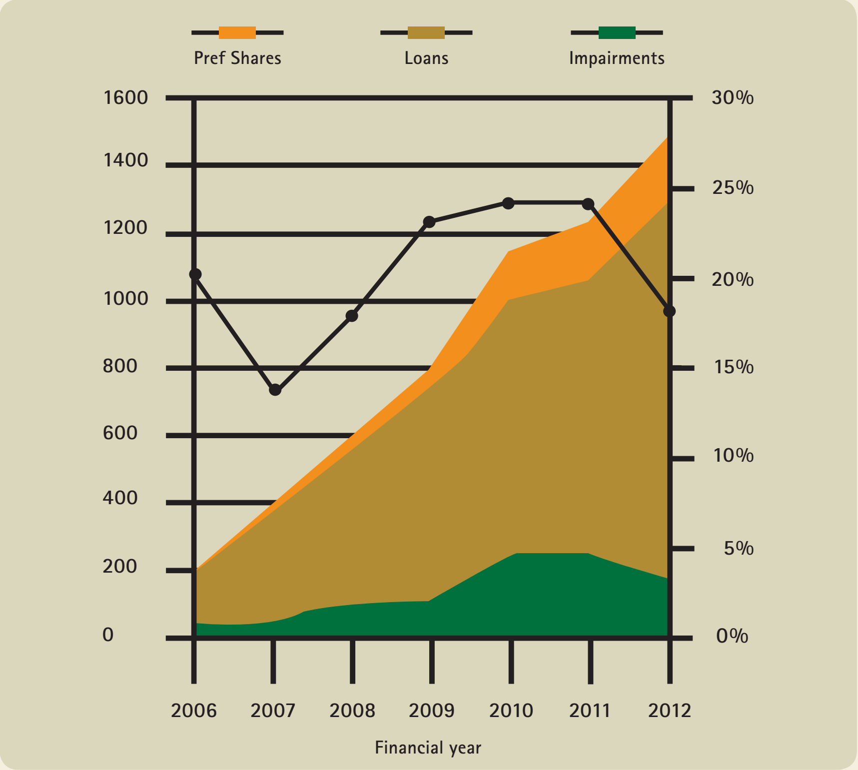
The largest single overhead that the NEF continues to report is its investment in human capital. This year staff salaries represented 56% of total overheads (2011: 55%). This is indicative of the NEF's planned dependency on experienced, highly technically competent professional staff for the overall successful implementation of its strategic plan. The NEF has become an employer of choice amongst black professionals and it aims to continue to attract and retain the best possible skills in the market. The ratio between professional and support staff has been maintained at two professional staff members for every one support staff member.

The quality of the investment portfolio and the loans book has significantly improved over the year under review. This is largely assessed against the risk of loan instalments raised not being honoured by investees, leading to increased impairments raised against loans. It is also assessed against the risk that the fair value of equity investments is below the carrying value of these investments, which would lead to impairments raised against equity being carried at cost or to a reduction in fair value in the case of equity investments being carried at fair value.

The NEF is pleased to report that in the year under review there was a marked reduction in the effective percentage value of impairments raised against the carrying value of the loans portfolio from 24.5% in 2011 to 19% in 2012 as reported in Figure 2. This was led by an improvement in the collections ratios of instalments raised for the year from 82% in 2011 to 97% for 2012 and associated overall reduction in the ageing of the loans book. Of the impairments raised on loans, 8.0% has been attributed to write offs (2011: 6.8%) - again, an overall improvement in performance and reduction in risk associated with the loans portfolio.

> *"The potential of the green economy is being recognized and it presents new investment opportunities."*
>
> Minister Ebrahim Patel, During opening of COP 17 in Durban, 28 November 2011.

Figure 2: Ratio of impairments and write-offs within the loans book



The NEF continues to closely monitor the level of loans currently in moratorium at any reporting point. Normally this ranges between 35% and 40% of the carrying value of the loans portfolio. It has, however, increased to 48% of the value of the loans portfolio at reporting date due to the surge in disbursement activity in the last quarter of the year. These loan moratoriums are designed to provide an equity-type buffer for cash flows at an early stage of business and normally last between three and twelve months. This ratio should thus progressively drop over the course of the current year back into the range of 35% to 40%.

A further key consideration is the portfolio make-up as reflected in Figure 3, which indicates that interest-bearing lending remains the focus of the NEF. Loans, preference shares and suspensive sale advances account for 81% of the portfolio (2011: 80%). This bias in favour of the interest-bearing structure in lending provides the NEF with the required element of predictable return needed to build a sustainable investment fund, as well as the element of predictability required to estimate impairments, though this must be done in full consideration of the level of loans in moratorium at that specific reporting date.

Fair value movements on the equity portfolio for the year are negative, led by the year-end market losses on the held-for-trade equities where the NEF has retained minor equity positions for short term gain in a few listed entities that were funded as part of the NEF's mandate, mainly in the listed property sector.

No significant fair value appreciations in the equity held in associates have been reported this year, with many of these investments focusing on their commercial sustainability in their respective sectors as opposed to equity appreciation in generally difficult business environments.

Figure 3: Portfolio Make-up

COST

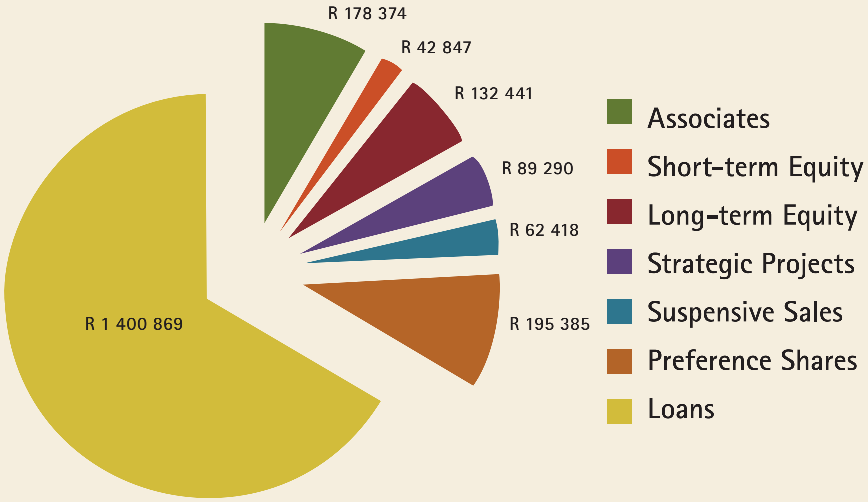
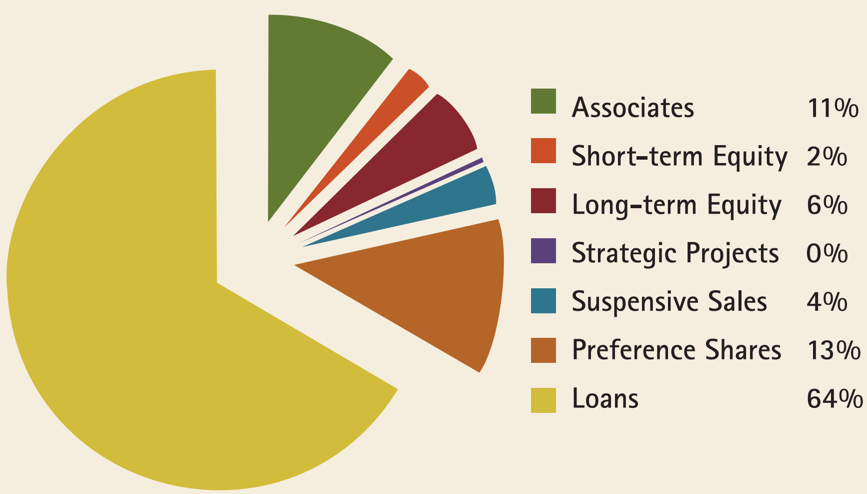


Figure 4: Portfolio Make-up

FAIR VALUE



The overall return on the portfolio before impairments for the year is 7% (2011: 9%) and after the impact of impairments is 3% (2011:1.2%). Despite the overall lower gross return dropping year-on-year due to the impact of falling interest rates, the reducing effect of impairments has resulted in the net return of the portfolio increasing to 3%. This is a positive result and certainly in the right direction, indicative of a sustainable investment portfolio able to support the operations of the NEF in the future.

Capital adequacy for future mandate

Capital is available to meet projected disbursements and hence the mandate for the next two years to the year ending March 2015. Thereafter, in the absence of the introduction of additional capital, sufficient capital is available to maintain portfolio management activity but not to meet additional new mandated disbursements.

The Board and management of the NEF are clearly aware of the need to raise additional capital for the purpose of continuing to meet its mandate through the disbursement of new investments beyond the two year projection expressed above. Various alternatives are being considered at present. They entail:

Re-applying to National Treasury to be re-classified under Schedule 2 of the PFMA so as to allow the NEF to present a capital raising plan on the strength of the NEF's own Statement of Financial Position

Establishing a special purpose vehicle to raise capital to follow through on any equity rights that materialise in the Strategic Projects Fund

- In lieu of the first two alternatives, re-applying to National Treasury for funding via the Medium Term Expenditure Framework process

General support exists within the NEF to embark on a sustainable fund management model involving the raising of additional capital to fund portfolio growth and extend the impact made through investment activity in black empowered business. Thus there is a high level of confidence that the NEF will be successful in at least one of the initiatives set out above and establish itself as a major development finance institution in South Africa. There is no reason for the going concern principle not to be adopted in the financial reporting of the NEF.

The NEF was established to support black empowered business which is unable to raise funding from other institutions due to inadequate own collateral. This market failure continues today and the mandate of the NEF remains relevant. The maintenance of the momentum achieved by the NEF as reported on at the commencement of this report, through capitalisation for the growth of the fund, is imperative if the impact of the NEF's mandate is to be meaningful in the context of the broader level of economic inequality which exists in South Africa today, and for which the NEF was established to fundamentally address.

Mr. Andrew Wright
Chief Financial Officer