

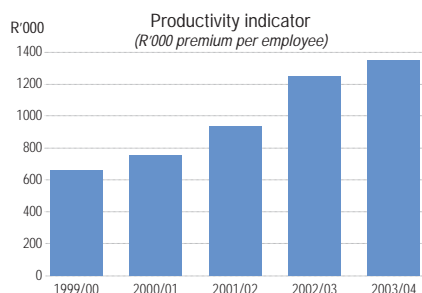
# MANAGING DIRECTOR'S REVIEW OF OPERATIONS



**MIKE TRUTER**  
Managing director

**A**FTER A PROLONGED PERIOD of unacceptable underwriting results in the credit insurance industry worldwide, leading insurers internationally adopted more disciplined underwriting standards and higher rates, which led to moderate global insurance results in the past year. The local economy is in good health and the incidences of business defaults and insolvencies in South Africa were at their lowest levels for many years. Against this backdrop, I am pleased to report that the company produced excellent results during the reporting period covered by these financial statements.

At Credit Guarantee, our most significant competitive edge continues to be our team of highly committed staff who are dedicated to providing our clients with an outstanding service. I am deeply grateful to each and every one of them for their loyalty and enthusiasm.



## REVIEW OF RESULTS

The results contained in this report are for the 18 months ended December 2004 with comparative figures being for the 12 months

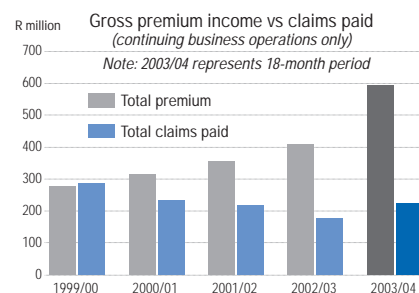
ended June 2003.

Premium income in our ongoing operations grew satisfactorily and stood at R598,7 million for the 18 months ended December 2004 compared to R410,3 million for the 12 months ended June 2003.

Total premium income (R678,6 million compared to R519,3 million for the 2003 financial year) was affected by the loss of income due to the run-off of our medium-term political risks contract with government and the termination of our international reinsurance-inwards portfolio.

Favourable underwriting conditions both locally and internationally and the absence of significant political events leading to catastrophic political claims resulted in fewer business defaults and insolvencies and lower claims in both our domestic and export portfolios. Total claims for the period under review reached R398,9 million compared to R404,6 million for the 12-month period ended 30 June 2003.

The underwriting surplus for the 18 months under review was R137,3 million, compared to R39,0 million for the 12 months ended 30 June 2003.



## Continued operations:

### Domestic credit insurance:

During the period under review we paid claims totalling R181 million in our domestic portfolio compared to R152,7 million for the year ended June 2003.

The South African economy is in a healthy state, driven by strong

domestic demand and low interest rates. The effect of this was lower levels of business failures and defaults than in recent years. Good growth in premium income, together with the abovementioned factors, resulted in a healthy surplus in our domestic underwriting account. Attentive monitoring of risks played an important role in this result.

I am grateful to Cliff Simons and his motivated team for their commitment.

The ongoing strength of the rand is, however, beginning to have a negative impact on a number of industries. The first signs of a severe deterioration in credit risks in certain sectors of the economy is now evident – notably those exposed to cheap imports and those which have invested heavily in export infrastructure. In our view this is likely to lead to escalating claims in the coming year.

*Export credit insurance:*

In stark contrast to domestic demand, South Africa's overall export growth was depressed over the past 18 months. Consequently, growth in our export premium income was below expectation.

Export claims totalling R44,8 million for the 18 months were well within budget (R39,5 million for the 12 months ended June 2003). This meant that our short-term and medium-term export portfolios produced a satisfactory underwriting result during the period under review.

Prospects for the coming year will, however, be heavily influenced by factors such as the value of the rand and the ability of South African exporters to recapture markets they have lost in recent years. We will continue to assist such exporters wherever we can.

I would like to extend my personal thanks to Gernot Krüger and his team for the hard work they have put into producing this pleasing result under very difficult circumstances.

**Discontinued operations:**

*Reinsurance inwards:*

As previously reported, a decision was taken during 2002 to discontinue our reinsurance-inwards activities because of consistently unsatisfactory results from this portfolio. Definitive notices of cancellation were sent to all foreign cedents with effect from 1 January 2003 and this business is in run-off.

During the past 18 months R30,7 million in claims was paid (R53,4 million in 2003) – all of which was reserved for at the end of the previous financial year. We believe we are fully reserved for the remaining run-off of claims in this portfolio.

**Medium-term export credit insurance**

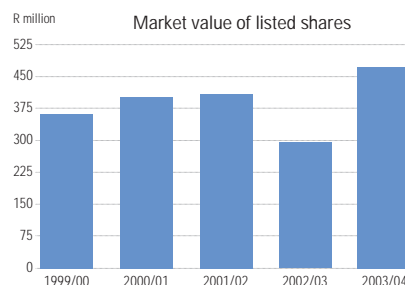
Premium income arising from the run-off of our medium-term political risks reinsurance contract with the South African government which was terminated in 2001, amounted to R71,1 million during the past 18 months (R64,6 million in the 2003 financial year). We will continue to administer this portfolio until its extinction.

**Investments**

Investment income for the 18 months ended December 2004 totalled R32,3 million compared to R26,3 million in the 12 months ended June 2003.

A significant appreciation in the stock market over the period under review, together with selective purchases, resulted in our share portfolio increasing in value by R113,0 million (reduction of R106,2 million during the 2002/03 financial year). These profits/losses have been reported through the company's income statement as is now required in terms of GAAP. The company's investment portfolio remains of an exceptionally high quality as can be seen from the schedule on page 39 of this report.

My thanks go to Wilhelm Lategan and Luke Doig for their professional management of this important portfolio.



**Support services**

The support divisions of the company are expected to provide the highest levels of service to the front-line divisions to enable them to deliver the standard of service our clients expect of us. Special mention needs to be made of the following:

*Credit-risk assessment and information gathering:* No credit insurer can produce sustainable positive underwriting results and a speedy turnaround time to requests for credit decisions without superior credit information gathering capabilities.

I am pleased to say that our strategy of building on the capabilities of this department over past years has paid dividends in that we can predict many business failures, both locally and internationally, long before they occur. This has had a significant impact on claims ratios

during the past reporting period.

My thanks go to Clive Robertson and his team for their diligent monitoring of these risks.

*Information Systems:* Constant development in the area of technology has proven to be a key element in the provision of superior service to our clients.

During the reporting period, we further enhanced a number of new programmes. Most noteworthy of these was a new claims system which took many months to develop. This innovation has enabled us to significantly improve our efficiency in processing claims, thereby improving our service delivery. More than 60% of client transactions are now conducted with us electronically.

I am grateful to Sandro Vita and his team for their hard work and dedication.

*Marketing and R&D:* Our aim is to consult with our clients and brokers in order to determine their needs continually. This process is focussed on developing appropriate products and services to provide the market with the best credit insurance solutions available. During the period under review, a number of new products and revisions of our procedures resulted from these independently commissioned surveys.

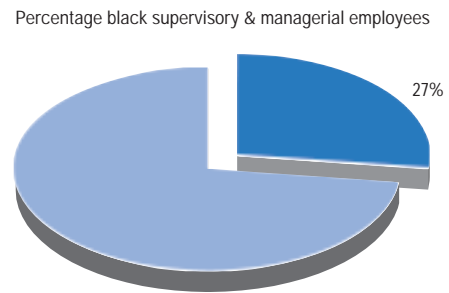
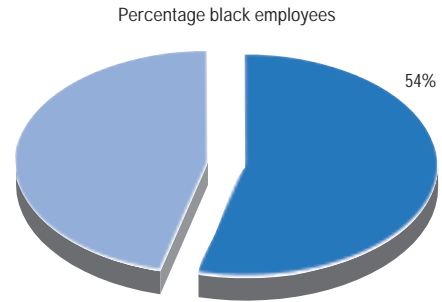
In addition to its marketing and research responsibilities, this division is tasked with managing our relationship with our specialist brokers. I am pleased to say that this functions extremely well.

My thanks go to Roger Munitich and his team for the good work they are doing in this area.

*Human Resources:* Human capital is our single most important asset. With this in mind, our aim is to provide our employees with a work environment that offers opportunities to all, irrespective of race, creed or gender. This is managed by our human resources division which ensures that we are appraised of the latest developments and requirements in the human resources and training arena.

As at 31 December 2004, black employees comprised 54% of the company's headcount, occupying 27% of supervisory or managerial positions. Women made up 61% of the company's employees and filled 53% of our supervisory or managerial positions.

We comply in all material respects with the Skills Development Act, the Employment Equity Act, and support the aims of the Broad-Based Economic Empowerment Act as well as the human resource development provisions of the Financial Sector Charter. The company's status regarding the targets set by industry under the charter are reported on page 13 in these financial statements.



Gloria Mokoena and her human resources team are doing outstanding work in managing this extremely important area of our business.

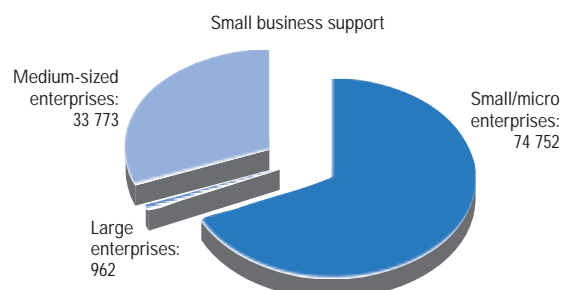
*Accounting and internal services:* Our accounting and internal services division is tasked with a myriad of important support functions. These range from debtors control to printing and messenger services as well as maintenance of our infrastructure and buildings – all of which must function flawlessly if we are to provide a superior service to our clients.

I am pleased to say that all of these perform excellently – for which I must thank Wilhelm Lategan and Johan Schnetler and their team.

## OTHER ISSUES

### *Support for small, medium & micro enterprises*

During the reporting period, we insured transactions to a total value of more than R55,6 billion on 109 487 debtors. More than 74 752 of these businesses fall within the official definition of small, medium and micro enterprises (SMMEs). This figure represents over 68% of the number of debtors we underwrite.



Many of these businesses would not have obtained trade credit were it not for the insurance cover we provide to their suppliers for the payment risks in question.

*Claims paying ability rating*

International rating agency Global Credit Rating (GCR) has reaffirmed Credit Guarantee's claims paying ability rating of AA (double A). The rating signifies "a very high claims paying ability with strong protection factors. Risk is modest, but may vary slightly over time due to economic and/or underwriting conditions".

*Financial Sector Charter*

In terms of the Financial Sector Charter, Credit Guarantee, together with every other financial institution in the country, has made a commitment to:

- Invest in human resource development, with special emphasis on accelerating the participation of black people at senior and managerial levels within the organisation;
- Increase the number of black directors at board level;
- Implement a learnership programme for black matriculants;
- Implement a targeted procurement strategy to enhance the percentage of purchases from BEE suppliers;
- Mobilise resources for empowerment financing;
- Direct a percentage of funds to corporate social investment and consumer education programmes; and
- Have a minimum percentage of black ownership, measured both at holding company and direct level.

A number of programmes to address these issues are under way at Credit Guarantee and we will be submitting our first annual report to the Charter Council within the prescribed timeframe. Some recent statistics reflecting the company's progress in the field of employment equity and social responsibility are:

Percentage of black representation at board level . . . . .	30,0%
Percentage of black representation at executive level . . . . .	12,5%
Percentage of black representation at senior management . . . . .	8,3%
Percentage of black representation at middle management . . . . .	23,1%
Percentage of black representation at junior management . . . . .	37,1%
Percentage of payroll spent on black skills development . . . . .	1,1%
Learnerships as percentage of total employees . . . . .	4,5%
Corporate social investment as % of after-tax profits . . . . .	0,5%

While some of the above figures are already at the minimum prescribed by the Financial Sector Charter, others still have some way to go before we achieve the targets set for the year 2008.

Management has set interim goals for the intervening years.

**CORPORATE GOVERNANCE**

The board of directors, executive management and staff of Credit Guarantee fully support the recommendations made by the King Committee on Corporate Governance and believe that the company complies in all material respects with the Code.

**Board of directors**

The board of directors consists of two executive directors and eight non-executive directors, five of whom represent the shareholders of the company and three of whom are independent. All directors have been selected for their experience and business acumen.

The roles of the chairman of the board and the managing director do not vest in the same person. The chairman is non-executive and this position is available for election at least every three years.

In terms of the Articles of Association, one-third of the non-executive directors retire by rotation and are subject to re-election each year at the company's annual general meeting. The executive directors have service contracts with the company containing normal notice periods.

The board meets formally a minimum of four times a year to discuss quarterly results, and annually to approve the strategic plan, key policies and budgets for the coming year. Additional meetings are held if and when the need arises.

A number of sub-committees have been appointed by the board to assist in discharging its duties, details of which are provided below.

Board members have direct access to the company secretary and are entitled to obtain independent professional advice at the company's expense.

An executive committee, chaired by the managing director and comprising of the heads of the various strategic units, meets weekly to deal with the day-to-day running of the company.

**Risk, Audit & Compliance Committee**

A Risk, Audit & Compliance Committee functions within written terms of reference approved by the board of directors. The objective of the committee is to support the board in ensuring that appropriate internal and external controls are in place to identify and manage the risks to which the company is exposed.

The committee comprises three members, all of whom (including the chairman) are non-executive directors.

The committee meets at least four times a year. The internal and

external auditors of the company attend these meetings and have unrestricted access to the chairman of the committee. The managing director and financial director attend meetings as representatives of management.

### **Remuneration and Nominations Committee**

The Remuneration and Nominations Committee consists of three non-executive directors and is presided over by the chairman of the board of directors.

This committee considers nominations for appointment to the board of directors and makes recommendations to the board on remuneration and benefits to be paid to directors and the company's employees. The committee sets the remuneration of the managing director and those of the general managers of the company. The managing director and financial director attend meetings as representatives of management.

### **Internal audit**

The purpose of the internal audit function, which reports to the managing director and the chairman of the Risk, Audit & Compliance Committee, is to assist management and the board in the examination and evaluation of business risks facing the company. This function operates within written terms of reference and adheres to the standards and code of conduct outlined by the Institute of Internal Auditors of South Africa. Any material control weaknesses which it identifies are brought to the attention of the chairman of the Risk, Audit & Compliance Committee and, if necessary, the board of directors for consideration and appropriate action.

During the reporting period this function was performed by the Management Assurance Services division of KPMG Inc.

### **Investment Committee**

The Investment Committee reports to the board of directors and operates within a written mandate setting out its terms of reference.

This committee is comprised of the managing director, the financial director and the senior manager (investments), and meets monthly with the company's professional investment advisors to review the company's share portfolio.

The committee submits quarterly reports to the board on the performance of the investment portfolio.

### **Internal control**

The board acknowledges its accountability for the company's internal control systems. Responsibility for the implementation of these systems is delegated to management who have installed

systems which incorporate clear levels of responsibility and accountability through the company's mandate system.

The board performs a monitoring function over these activities.

We have implemented ISO 9001:2000 as an additional system to complement our internal controls. In November 2004, the South African Bureau of Standards reaffirmed our ISO 9001:2000 status.

The company also subscribes to Tip-Offs Anonymous, a Deloitte & Touche initiative that enables employees, clients and the marketplace to alert this independent entity, in confidence, about wrong-doings that need to be exposed.

Finally, with the implementation of the FAIS (Financial Advisory and Intermediary Services) Act, the company is compelled to comply with a number of factors aimed at protecting public interests.

### **Risk management**

The Risk Management Committee is under the chairmanship of the financial director and comprises the divisional heads of key departments. It meets regularly to assess risks and to satisfy itself that adequate controls are in place to manage these risks.

### **HUMAN CAPITAL**

The company believes in creating a stimulating working environment in which every person who works for Credit Guarantee enjoys equal rights. To this end, we have adopted an employment equity policy which enables all employees to enjoy equal opportunities regardless of race, creed, physical ability or gender. This policy contains agreed targets and numeric goals which are regularly monitored by management. The board of directors has approved the company's Employment Equity Plan. Annual reports are sent to the Department of Labour as required by the Employment Equity Act. All requirements prescribed by the Skills Development Act have been met.

The process is driven by a dynamic and dedicated Employment Equity Committee, working hand-in-hand with executive management.

### **ETHICS**

The company has adopted a formalised code of ethics which commits management and employees to a high standard of principles. This code is encapsulated in the staff manual and forms part of our induction and training programmes.

The company also subscribes to the Industry Code of Conduct and Ethics as published by The South African Insurance Association.

## CORPORATE SOCIAL INVOLVEMENT

The company subscribes to the principle of responsible corporate citizenship and has adopted a number of social programmes in the area of education and training. We also contribute to disadvantaged groups through a number of social responsibility programmes, including:

- A bursary scheme to assist deserving pre- and post-matric learners who are unable to finance their own studies. During the past 18 months, more than 65% of these funds were devoted to people from disadvantaged backgrounds;
- Contributing to the SA Conservation Education Trust which provides support for environmental issues and relevant training of rural people;
- Support for the Ebenezer Care Centre, a home for abandoned children and elderly people, and
- A formalised donations budget, under the control of the financial director, which supports a number of charities and other deserving causes.

## FINANCIAL STATEMENTS

Management is responsible for the preparation of annual financial statements and related information in a manner that is accurate and fairly represents the company's financial position.

These financial statements are prepared in accordance with South African Statements of Generally Accepted Accounting Practice based on appropriate accounting policies, and any changes to these policies are fully disclosed. The statements are supported by reasonable and prudent judgements and estimates and also give an indication of company expectations for the coming year.

The directors have no reason to believe that the company's operations will not continue as a going concern in the year ahead.

## MANAGEMENT REPORTING

Management reporting disciplines are diligently observed. Budgets are submitted for board approval and results are reviewed quarterly against budgets.

Management maintains internal controls and systems to ensure the integrity of financial statements. These controls are based on established policies and procedures and are under the supervision of qualified personnel.

## ACKNOWLEDGEMENTS

*Our people:* I owe a special word of thanks to our people – the

employees of Credit Guarantee – for their commitment over the past 18 months. Your dedication and hard work were major factors in the strong results the company has managed to produce.

*Our board:* I would like to thank our board of directors for their support and advice over the past 18 months. We, as management, are extremely fortunate to have a board with such depth of business acumen and experience.

*Our specialist brokers:* My thanks are due to the undermentioned specialist brokers for their support and the professional manner in which they conducted their business with us over the past 18 months. It is one of our highest priorities to provide you, and our mutual clients, with the best credit insurance solutions available:

- Alexander Forbes – Risk Services
- Aon South Africa – Trade Credit Division
- Credit Insurance & Legal Consultants
- Glenrand MIB
- GSK Credit Insurance Brokers
- Marsh South Africa
- Nateng Brokers
- Niché International Brokers
- Prestige Credit Insurance Consultants
- Top Cover
- Thompson Credit Insurance Consultants  
(a GIB Group company)
- Willis SA

*Our reinsurers:* My thanks go to our reinsurers for their support and the professional relationship we have enjoyed with them over the past 18 months. We are fortunate to have the backing of the strongest and most respected institutions in the world.

*Our clients:* Finally, and most importantly, I would like to extend a word of personal thanks to our clients for their support over the years. You remain our highest priority!



Managing Director

## Solutions based on in-depth knowledge



The hammer, which was the first tool used by man, underwent several design changes over the centuries. Hafted hammers, with the stone head bound to the handle by thongs, appeared during the Middle Stone Age period, around 8 000 BC. The standard carpenter's hammer, known as a claw hammer because of the V-shaped claw used for extracting nails, came into use in Roman times.

The effectiveness of the hammer was the result of really understanding the operating environment and the problem. It is this same in-depth understanding of clients' needs and challenges, driven by knowledge of the business environment, that allows Credit Guarantee to deliver lasting solutions.

### A T A G L A N C E

A risk management committee, headed by the financial director, addresses and manages the major risks to which the company is exposed.

Credit Guarantee has long followed a conservative money market strategy, investing in accordance with predetermined limits and approved procedures. Our objective is to limit possible losses and ensure the timely availability of funds in order to meet commitments. No forward exchange contracts were entered into in the year under review.

The company invests in blue-chip and potential blue-chip shares on the JSE Securities Exchange. Investment strategy is focused on maximising long-term capital growth and minimising risk exposure while maintaining liquidity levels.

A comprehensive operational risk policy guards against loss resulting from errors in the processing of transactions, breakdown in controls and errors or failures in system support.

Reinsurance requirements are purchased on an annual basis according to the company's core business exposures.



# RISK MANAGEMENT AND ANNUAL FINANCIAL STATEMENTS



## RISK MANAGEMENT

Risk management in its widest sense forms an integral part of Credit Guarantee's day-to-day operations. Increasing governance standards require that risk be considered in a reasonable, consistent and explicit manner across the organisation.

The objective of risk management is to identify, assess, manage and monitor the risks to which the business is exposed. Specific responsibility for the management of these risks has been assigned to executive management.

A risk management committee addresses and manages the major risks to which the company is exposed. The committee is headed by the financial director with representation from the major divisions in the company. A comprehensive risk management profile has been developed for the company, and risk profiles are reviewed on an annual basis.

## MONEY MARKET AND FOREIGN CURRENCY RISKS

The primary objective of Credit Guarantee's money market operations is to invest surplus cash holdings in such a way as to limit possible investment losses and to ensure the timely availability of funds to meet our commitments.

A conservative investment strategy is followed by investing only with approved financial and public sector institutions according to

predetermined limits, approved annually by the board of directors. Dealing in money market derivative instruments is not part of the company's investment policy unless prior approval is obtained from the board.

All money market transactions are authorised in accordance with approved procedures.

No forward exchange cover contracts were entered into because the liabilities of future foreign claim payments emanating from our reinsurance inwards business were not known. However, deposits in foreign currency were made to foreign cedents to match the then outstanding claims reserves when we discontinued our reinsurance inwards treaties. This arrangement provides for a certain degree of matching liabilities with foreign currency risks.

Foreign information expenses are paid for as and when information is bought.

## INVESTMENT RISK

The objective of Credit Guarantee's investment guidelines is to invest in blue-chip and potential blue-chip shares on the JSE Securities Exchange of South Africa to maximise capital growth in the long term and to minimise exposure to losses from share dealings. Investments in equities must not put unnecessary liquidity risk on the company. The term "liquidity risk" describes the risk of not having sufficient cash resources to meet financial commitments. An investment committee meets monthly with the company's professional investment advisors to discuss strategy and quarterly with the board to decide policy and review cashflow forecasts.

## OPERATIONAL RISK

Operational risk is the risk of loss resulting from errors (fraudulent and administrative) in the processing of transactions, breakdown in controls and errors or failures in system support. Credit Guarantee guards against these risks by:

- Regularly updating systems and procedures;

- Daily updating buyers' information;
- Ensuring audit compliance before paying major claims;
- Training programmes for staff in underwriting and claims assessing;
- Testing and appraising based on output-measuring job models;
- Regular internal and external audits;
- Appropriate insurance policies to cover buildings, fixed assets, professional indemnity, fidelity guarantees and other identified insurable risks;
- A code of conduct which encourages honesty and integrity; and
- Complying with ISO 9001:2000.

The primary objective of the management of operational risks is to identify possible weak links in systems and controls in order to strengthen these procedures.

A computer system disaster recovery plan is in place to ensure the continuity of computerised business systems.

## **REINSURANCE RISK**

The company purchases its reinsurance requirements on an annual basis according to its core business exposures.

As a risk management process, our net risk per exposure is limited to an internationally acceptable percentage of our net worth. This exposure is carefully monitored to ensure adequate coverage at all times. Reinsurance requirements are placed with the world's leading reinsurers who offer the best security, as they are highly rated by international rating agencies.

A handwritten signature in blue ink, appearing to read 'W. Hategan', with a large loop at the end of the last name.

Executive director: Finance

# REPORT OF THE INDEPENDENT AUDITORS

## TO THE MEMBERS OF CREDIT GUARANTEE INSURANCE CORPORATION OF AFRICA LIMITED:

### Introduction

We have audited the financial statements of Credit Guarantee Insurance Corporation of Africa Limited for the 18 months ended 31 December 2004 as set out on pages 17,18, 21 to 38. These annual financial statements are the responsibility of the company's directors. Our responsibility is to express an opinion on these financial statements, based on our audit.

### Scope

We conducted our audit in accordance with Statements of South African Auditing Standards. These standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatements.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures included in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and

- Evaluating the overall financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

### Opinion

In our opinion, these annual financial statements fairly present, in all material respects, the financial position of the company at 31 December 2004 and the results of its operations and cash flow information for the 18 months then ended, in conformity with South African Statements of Generally Accepted Accounting Practice and in the manner required by the Companies Act in South Africa.

DELOITTE & TOUCHE

Deloitte & Touche  
Chartered accountants (SA)  
Registered accountants  
& auditors

Johannesburg

3 February 2005

Nkonki Inc.

Nkonki Inc  
Chartered accountants (SA)  
Registered accountants  
& auditors

Johannesburg