

ANNUAL REPORT OF THE BOARD OF DIRECTORS

GENERAL

The Board of Directors of Diesel & Motor Engineering PLC have pleasure in presenting the Annual Report of the Board of Directors and audited Consolidated Financial Statements for the year ended 31st March 2009, approved by the Board on at a meeting held on 22nd May 2009.

The Financial Statements have been prepared in accordance with the Sri Lanka Accounting Standards as required by the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 and conform to the requirements of the Companies Act No. 7 of 2007.

PRINCIPAL ACTIVITIES

The principal activities of the Group include import, sale and repair of passenger cars, commercial vehicles, material handling machinery, storage systems, construction machinery, agri machinery, medical equipment, telecommunication equipment, power engineering solutions, power engines, power tools and import and sale of vehicle spares, components, accessories and lighting products. Group activities also include manufacture and sale of Auto filters and retreaded tyres.

There was no significant change in:

- The nature of the business of the Company or its subsidiaries.
- The classes of business in the associate Companies during the year, that may have a significant impact on the state of the Companies affairs.

GROUP STRUCTURE

A diagram depicting the Group Structure is available on page 100.

BUSINESS REVIEW AND FUTURE DEVELOPMENTS

A review of financial and operational performance and future business developments of the Group are contained in the Chairman and CEO's Review (Pages 6 to 9) and Business Performance Report (pages 16 to 45). These reports together with the Audited Financial Statements reflect the state of affairs of the Company and Group.

FINANCIAL STATEMENTS

The Financial Statements of the Company and the Group are given on pages 110 to 136.

AUDITORS' REPORT

The Auditors' Report on the Financial Statements is given on page 109.

SIGNIFICANT ACCOUNTING POLICIES

The Significant Accounting Policies adopted in the preparation of Financial Statements are given on pages 115 to 120.

The accounting policies set out in the Financial Statements consistent with those used in the previous year, other than for the effects of SLAS 16 (Revised 2006) - Employee Benefits which was adopted during the year.

DIRECTORATE

List of Directors

Following were the Directors of the Company as at the end of the financial year and their qualifications and experiences are given in the Board of Directors section on pages 10 and 11. of this Annual Report.

- A.R. Pandithage (*Chairman/Managing Director/Chief Executive Officer*)
- A.G. Pandithage (*Deputy Chief Executive Officer*)
- A.N. Algama (*Executive Director*)
- S.C. Algama (*Executive Director*)
- Dr. H. Cabral (*Independent Non-Executive Director*)

- B.C.S.A.P. Gooneratne (*Executive Director*)
- Dr. U. Liyanage (*Independent Non-Executive Director*)
- A.M. Pandithage (*Non-Executive Director*)
- T.G.H. Peries (*Executive Director*)
- R. Seevaratnam (*Independent Non-Executive Director*)
- R.C. Weerawardane (*Executive Director*)

Resignations, New Appointments and Re-elections to the Board

Mr. R.A. Ebell has resigned from the Board with effect from 30th June 2008. There were no new appointments made to the Board, during the year.

Mr. A.G. Pandithage, Mr. A.N. Algama, Mr. T.G.H. Peries and Mr. R.C. Weerawardane retired by rotation in accordance with the Articles of Association and were re-elected to the Board at the Annual General Meeting held during the year.

Dr. H. Cabral, Mr. B.C.S.A.P. Gooneratne, Mr. S.C. Algama and Dr. U. Liyanage retire by rotation in accordance with the Articles of Association and being eligible offer themselves for re-election at the Annual General Meeting.

DIRECTORS' RESPONSIBILITIES FOR FINANCIAL STATEMENTS

The Statement of Directors' Responsibilities for the Financial Statements is given on page 108 of this Annual Report.

DIRECTORS' SHAREHOLDINGS

The Directors and their spouses held 3,476,894 (2007/08 - 3,383,477) ordinary shares of the Company, which amounts to 39.95% (2007/08 - 27.96%) of the ordinary shares issued as at 31st March 2009.

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The shareholdings of Directors and their spouses as at 31st March 2009 are as follows:

As at 31st March	2009			2008		
	Shareholding - No. of Shares			Shareholding - No. of Shares		
	Director	Spouse & Children under 18	Total	Director	Spouse & Children under 18	Total
A.R. Pandithage	971,798	910,297	1,882,095	971,798	910,297	1,882,095
A.N. Algama	264,172	–	264,172	170,755	–	170,755
A.M. Pandithage	178,745	41,033	219,778	178,745	41,033	219,778
A.G. Pandithage	339,380	44,165	383,545	339,380	44,165	383,545
S.C. Algama	392,278	6,856	399,134	392,278	6,856	399,134
T.G.H. Peries	191,284	136,886	328,170	191,284	136,886	328,170
	2,337,657	1,139,237	3,476,894	2,244,240	1,139,237	3,383,477

INTEREST REGISTER

The Interest Register is maintained by the Company as required by the Companies Act No. 7 of 2007. The following entries were made in the year under review.

• Directors' Interest in Contracts

All Directors have made declarations on their interests in transactions or proposed transactions with the Company in accordance with Section 192 (2) of the Companies Act.

The Directors' interest in contracts are disclosed in the annexure on page 107.

• Acquisition/Disposal of Shares by Directors

Mr. A.N. Algama purchased 30,900 shares and disposed 9,200 shares of the Company during the year. Further, 71,717 shares were transmitted to Mr. A.N. Algama during the year.

There were no other acquisition or disposal of shares by any other Director during the period.

• Directors' Remuneration

Directors' remuneration in respect of the Group and the Company are given on Note 4 to the Financial Statements on page 123.

• Insurance

A 'Directors' and Officers' Liability insurance policy was obtained during the year.

DIRECTORS' MEETINGS

The details of the Directors' Meetings are presented in Report of the Enterprise Governance on page 90.

INTERNAL CONTROL SYSTEM

The Group Management Committee including the Executive Directors have taken necessary steps to overlook the implementation of an effective system of internal controls covering financial as well as operational activities of the Company. The Directors have outsourced a part of the internal audit function to review and report on the effectiveness of the internal controls.

BOARD COMMITTEES

The Board of Directors of the Company has formed the following sub committees and the Reports of such subcommittees are given on pages 97 to 99 of this Annual Report.

- Audit Committee
- Remuneration Committee
- Nominations Committee

AUDITORS

The Auditors - Messrs KPMG Ford, Rhodes, Thornton & Co., Chartered Accountants were paid Rs. 1.35 mn for the year ended 31st March 2009 (2007/08 - 1.18 mn) as Audit fees. In addition, Auditors were paid Rs. 0.43 mn (2007/08 - 0.15 mn) for Audit-related services and Rs. 0.63 mn (2007/08 - 0.71 mn) for non-audit service, in respect of the Group.

Based on the declaration made by Messrs KPMG Ford, Rhodes, Thornton & Co., Chartered Accountants and as far as the Directors are aware, the Auditors do not have any other relationship or interest in contracts with the Company or with any of its Subsidiaries.

The retiring Auditors - Messrs KPMG Ford, Rhodes, Thornton & Co., Chartered Accountants are willing to continue in their office. A resolution on re-appointing them as Auditors and granting authority to the Directors to decide their remuneration will be proposed at the Annual General Meeting.

TURNOVER

The Company recorded a turnover of Rs. 8,667 mn in 2008/09 (for 2007/08 - Rs. 12,169 mn). The Group turnover for 2008/09 is Rs. 9,274 mn (for 2007/08 - Rs. 12,687 mn).

Segment turnover and other segment information are available on pages 121 & 122.

HUMAN RESOURCES

The Group promotes to its employees the need for the highest standards of integrity and ethics in business dealings, including compliance with all relevant legislation and codes of practice. Employees are regarded as the key to being able to translate policies and strategies into commercial success.

The Group is committed to providing a working environment in which this process can succeed.

Adequate measures are taken to ensure that all employees have the opportunity to understand and appreciate the Group's objectives and policies. The employment policy of the Group embodies the principal of equal opportunity. The Group aims to create an opportunity for participation and involvement, encourage the identification and development of skills, promote the use of initiative and stimulate

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personal advancement. Reward systems recognise success at both the corporate and individual level. The number of persons employed by the Company and its subsidiaries at the year end was 870 (2007/08 - 867).

HEALTH AND SAFETY

The Group safeguards occupational health and hygiene of its employees by providing a safe working environment and complying with all relevant statutory obligations. The Group also has an employees' medical scheme and expenditure in relation to this for the year was Rs. 13 mn.

ENVIRONMENT

The Group is sensitive to the needs of the environment, not only in terms of compliance with relevant statutory obligations, but more generally in terms of the need to be efficient in the use of energy and water and in reducing the handling of waste material. It is the Group's policy to minimise adverse effects on the environment and to promote corporation and compliance with relevant authorities and regulations. The business activities of the Group can have an indirect impact on the environment if necessary preventive measures are not taken. The steps taken to prevent possible indirect impact are outlined in the Sustainability Report on pages 66 to 74.

QUALITY

The Group is committed to maintain its long established reputation of being a symbol of quality. All employees are encouraged to regard the continuous improvement of quality standards as a key to competitive advantage.

OPERATIONAL RESULTS AND DIVIDENDS OF THE GROUP

	2008/09 Rs. '000	2007/08 Rs. '000
Turnover		
The Gross Turnover	9,274,103	12,687,289
Profit		
After making provision for bad and doubtful debts and all known liabilities and after charging a sum of Rs. 97,615,652/- (2007/08 - Rs. 84,244,159/-) for depreciation of property, plant & equipment the profit made by the		
Group before tax was	155,021	344,444
Income tax expense	(65,577)	(139,351)
Group profit after taxation	89,444	205,093
Retained earnings brought forward	520,221	369,578
Surplus on actuarial valuation of retirement benefit obligations at the beginning of the year	8,028	-
Appropriations		
Dividend paid	(30,250)	(54,450)
Transfers to general reserve	(220,000)	-
Available for appropriation	367,443	520,221

Dividends on Ordinary Shares

The Directors recommend a first & final dividend of Rs. 3/- per share (2007/08 - Rs. 1.50 per share - Interim and Rs. 2.50 per share - Final) payable on 11th June 2009 to the shareholders of the issued ordinary shares of the Company as at close of the business on 2nd June 2009. In accordance with Section 56 of the Companies Act No. 7 of 2007, a solvency test was carried out by the Company's Auditors, prior to recommending the final dividend.

Income Tax Expense and Deferred Taxation

It is the Group's policy to provide for deferred taxation on all known temporary differences. The income tax rate applicable to all companies in the Group is 35%. Tax on export profit is 15%.

STATUTORY PAYMENTS

Directors confirm that all payments in respect of statutory liabilities including EPF, ETF and Taxes have been made on time during the financial year.

DONATIONS

The donations made during the year amounted to Rs. 786,936/- (2007/08 - Rs. 628,265/-).

PROPERTY, PLANT & EQUIPMENT

Group expenditure on property, plant & equipment during the year amounted to Rs. 118,097,174/- (2007/08 - Rs. 554,483,332/). Information relating to movement in property, plant & equipment is given in Note 8 to the Financial Statements.

MARKET VALUE OF FREEHOLD LAND

A qualified independent valuer last revalued the freehold land of the Company on 30th September 2008 and the carrying value of the freehold land has been adjusted accordingly. The details of the Freehold land are given in Notes to the Financial Statements on Page 127.

GROUP INVESTMENT

Information relating to investments other than in subsidiaries is available in Notes 12, 13 & 14 to the Financial Statements.

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STATED CAPITAL

The stated capital of the Company as at 31st March 2009 was Rs. 182.5 mn (in 2008 - Rs. 182.5 mn). The number of shares in issue as at 31st March 2009 was 8,702,389 (2007/08 - 12,100,000).

The Company acquired 3,397,611 of its own ordinary shares during the year. As per the provisions of the Companies Act No. 7 of 2007, own shares acquired are deemed to be cancelled immediately upon acquisition by the Company.

RESERVES

The total reserves as at 31st March 2009 stand at Rs. 1,822,344,084/- (2007/08 - Rs. 1,474,649,854/-) comprising capital reserves of Rs. 1,135,611,833/- (2007/08 - Rs. 311,521,385/-) and revenue reserves of Rs. 686,732,251/- (2007/08 - Rs. 1,163,128,469/-). The Statement of Changes in Equity on page 112 gives the movement in equity during the year.

SHARE INFORMATION

Information relating to shareholding, earnings and net assets per share, market value per share, dividends and share trading are available on pages 138 to 141.

SHAREHOLDINGS

There were 1,212 registered shareholders as at 31st March 2009. The percentage of shares held by the public as at 31st March 2009 was 45% of the issued shares. The twenty major shareholders as at 31st March 2009 and the number of shares held and their percentage shareholding are given on page 104.

COMPLIANCE WITH LAWS AND REGULATIONS

To the best of the knowledge and belief of the Directors, the Company has not engaged in any activities contravening the laws and regulations of the country.

OUTSTANDING LITIGATION

In the opinion of the Directors and in consultation with the Company Lawyers and legal counsel, litigations currently pending against the Company will not have an impact on the operations of the Company. The details of the litigations against the Company are given on page 136.

EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

There have not been any material events that occurred subsequent to the date of the Balance Sheet which require adjustments to or disclosure in the Financial Statements.

CONTINGENCIES AND COMMITMENTS

Contingent Liabilities and Capital Commitments made as at 31st March 2009 is given in Note 30 to the Financial Statements.

GOING CONCERN

The Board of Directors has reviewed Group's Budget, availability of banking facilities and other necessary information and is satisfied that the Group has adequate resources to continue in business for the foreseeable future. Accordingly, going concern basis has been adopted in preparation of the Financial Statements.

ANNUAL GENERAL MEETING

The Annual General Meeting will be held at the Registered Office of the Company, No. 65, Jethawana Road, Colombo 14 on 29th June 2009. The Notice of Annual General Meeting is given on page 156.

By order of the Board of Directors



A.R. Pandithage
*Chairman/Managing Director/
Chief Executive Officer*



R.C. Weerawardane
Director



B.C.S.A.P. Gooneratne
Secretary

Colombo
22nd May 2009