

OPERATING ENVIRONMENT AND TRENDS

Global Economic Environment

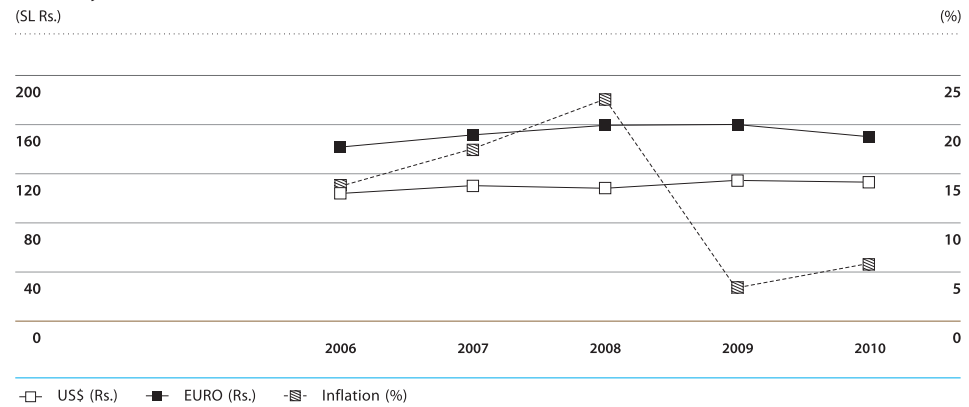
The global economy recovered in 2010 from its deepest recession since the 1930s, with an estimated growth rate of 5.0%, as compared to its contraction by 0.6% in 2009. Having been less affected by the financial turmoil that preceded the recession in 2009, emerging economies continued to be the engine of recovery during the year under review. This was also apparent in the automotive industry, where a significant resurgence in demand in the emerging markets was witnessed.

Changes in the vehicle mix were also seen during the year, particularly the commercial take-off of hybrid and electric vehicles, including all mainstream vehicle manufacturers demonstrating concepts and announcing plans to launch models across vehicle segments. Further, the impact of the recent earthquake and tsunami in Japan, a leader in the automotive industry, is expected to be temporary.

The Sri Lankan Economy

2010 was the first full year of operation subsequent to the end of the three-decade long conflict. The new found peace helped to create an environment conducive to realising Sri Lanka's true potential. The economy recorded an impressive growth rate of 8%, the highest for the past three decades. The growth took place across all key sectors comprising agriculture, industry and services. The economy was characterised by moderate inflation, a lower interest rate regime, foreign exchange stability and positive Government initiatives to reduce taxation and further liberalise exchange control.

Currency Vs Inflation



The Transportation Sector

This sector impacts on the sale of passenger vehicles, commercial vehicles, special purpose vehicles, vehicle spares, accessories and tyres of the Dimo Group. The vehicles segment accounts for about 70% of the Group's business and hence merits further discussion.

Some key statistics of the sector are given below:

Class of Vehicles	Registration of Vehicles				
	2006	2007	2008	2009	2010
Motor cars	27,578	22,603	20,237	5,762	23,072
Three-Wheelers	64,466	43,068	44,804	37,364	85,648
Motor Cycles	156,626	182,508	155,952	135,421	204,811
Buses	3,346	2,637	1,180	739	2,491
Dual-Purpose Vehicles	7,245	5,193	2,856	1,280	11,712
Goods Transport Vehicles	20,436	18,408	14,038	8,225	11,845
Land Vehicle	20,825	23,475	26,132	15,284	19,664
Total	300,522	297,892	265,199	204,075	359,243

Source - Central Bank of Sri Lanka.

The transportation sector demonstrated a noticeable improvement in 2010, seen predominantly in the road development sector. Construction of highways, expressways, bridges, rehabilitation of existing roads with special focus on roads in the Northern and Eastern Provinces and construction of rural roads under the 'Maga Neguma' programme continued in 2010.

Road passenger transportation, rail and bus transportation, port services and air transportation also recorded impressive performance, reflecting the recovery in economic activities.

Public passenger transportation showed mixed performance in 2010. Although SLTB owned a fleet of 7,746 buses, the operated average number of buses in 2010 was 4,441 per day compared to the requirement of 7,131 buses. Refurbishment of buses and adding them to the fleet was a progressive step taken by SLTB to maintain the operative bus fleet. The number of buses owned by private operators increased by 6.1% to 19,805 while the operated average number of buses increased to 15,884 in 2010.

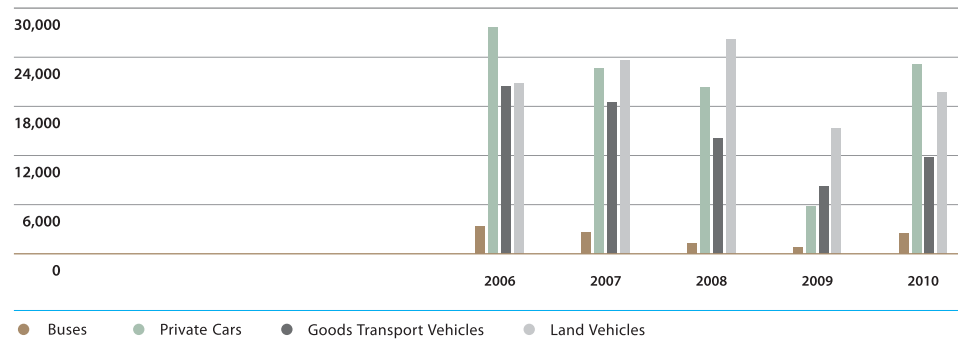
The vehicle import market recorded a 215% growth in value terms, increasing from Rs. 37 bn in 2009 to Rs. 117 bn in 2010, according to the Ceylon Chambers of Commerce. Vehicles from India continue to dominate the import market, with a share of over 50%.

A steep reduction in tax/duty on imported passenger vehicles in June 2010 served to inject life into the almost dead motor car trade, as can be seen from the statistics shown above.

Overall, the outlook for the Sri Lankan vehicle market is bright with consumers having a broad choice of brands and prices, a reasonable duty structure and stable petroleum prices. The continued lower interest rate regime, single digit inflation, a stable Rupee and balanced economic growth provide optimism for another good year.

Registration of Motor Vehicles

(Number of Vehicles)



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Agriculture and Fishing This sector impacts on the sale and service of earth moving equipment, agricultural machinery, industrial refrigeration industry and marine solutions.

Agriculture and Fishing account for about 11.9% of the GDP. It grew by 7.0% in 2010 compared to a 3.2% in the previous year, mainly due to the favourable growth in paddy, tea and minor export crops along with the significant improvement in the fisheries sector, particularly in the Northern and Eastern Provinces.

In parallel, the boat building industry showed signs of recovery. Demand for locally-manufactured commercial and leisure boats, small- and medium-scale luxury yachts increased during 2010. The emerging tourism industry, mainly in the sea fronts of Northern and Eastern Provinces, is expected to generate an increasing demand for leisure boats as well as vessels for sea excursions.

Industry and Services This sector impacts on the sale of road construction machinery, forklifts, material handling machinery, racking systems, power tools and accessories, lamps, lighting fittings and accessories of the Group.

The Industry sector recorded a high growth of 8.4% in 2010, compared to the moderate growth of 4.2% in the previous year. All sub-sectors contributed favourably towards this impressive performance, with factory industry and construction being the major contributors.

The construction sector expanded with the acceleration of road development projects and power projects. Further, port development projects together with construction of houses and reconstruction work done in the North and East, boosted construction activity.

The hotels and restaurants sub-sector grew sharply by about 39.8% underpinned by the strong performance in tourism due to the post-conflict peaceful environment.

Economic and Social Infrastructure This sector impacts on the sale of medical equipment, fluid management solutions, building technologies and power engineering solutions of the Group.

Power Sector Electricity generation increased by 8.4% to 10,714 Gwh in 2010 reflecting the growth in economic activities and the lower base in 2009. The construction work of phase I of Norochcholai Coal Power Plant was completed in 2010 while the Upper Kotmale Hydro Power Project was nearing completion.

The electrification level in Sri Lanka is substantially high, compared to many other countries in the region. With the ongoing rural electrification projects, it is expected to achieve almost 100% electrification by end 2012.

Electricity demand is forecast to grow by 8-9 % per annum over the next decade, with about 10% of the total demand being met through renewable energy by 2015.

The energy labelling programme carried out by the Sustainable Energy Authority (SEA) was successful and the penetration of compact fluorescent lights (CFLs) has supported the achievement of an annual energy saving of 22 Gwh. The SEA has planned to extend the energy labelling programme to other products as well. The estimated annual energy saving due to enhanced use of energy efficient equipment through the labelling programme is 240 Gwh.

Simultaneously measures are being taken to promote renewable energy sources such as wind and solar power.

Water Supply The demand for pipe borne water is growing continuously with the increased level of urbanisation, change in lifestyles and expansion of commercial and industrial activities. To meet the increasing demand, the National Water Supply and Drainage Board (NWS&DB) provided 87,245 new connections during the year, bringing the total to 1.35 mn connections, reflecting a 6.9% increase during the year.

Several major irrigation projects were in progress in 2010. The Uma Oya Multipurpose Development Project was in progress and is expected to irrigate 5,000 ha of new lands and provide for the drinking and industrial water requirements of the South-East dry zone. Some of the other projects implemented by the Irrigation Department include the Deduru Oya Reservoir Project, the Rambukkan Oya Reservoir Project, Weheragala Reservoir Project and the Lower Uva Minor Irrigation Project.

Health Sector Sri Lanka's health sector standards continued to improve.

The potential for promoting health tourism in Sri Lanka is significant, considering the existing competitive advantages of the industry such as the highly skilled and trained workforce and strategic location.

Economic Outlook and Implications

The vision of the Government of Sri Lanka to double the country's per capita income to US dollars 4,000 by 2016 and to turn Sri Lanka into the 'Wonder of Asia' requires a growth rate of around 8.0% to be maintained over the years ahead.

The plan to transform Sri Lanka into a strategically important economic centre by developing five strategic hubs - a knowledge hub, a commercial hub, a naval/maritime hub, an aviation hub and an energy hub - is a balanced strategy that takes advantage of Sri Lanka's strategic location and resources.

The decline in poverty that surpasses the target set under Millennium Development Goals (MDGs) and the continuous decline in unemployment are commendable achievements. The Poverty Head-count Index halved from 15.2% in 2006/07 to 7.6% according to the first-round information from the Department of Census and Statistics.

The key challenge in the years ahead is to create an environment that continues to attract private sector investment and the timely completion of ongoing and planned infrastructure and reconstruction projects, while maintaining a low and stable rate of inflation.

However, the current geo-political tensions in the oil producing regions are likely to exert pressure on international crude oil prices as well as Sri Lanka's oil import bill, and thereby on the trade deficit. Therefore, the challenge for Sri Lanka is twofold; to maintain the growth momentum achieved in 2010, while at the same time being prepared to face the impact of adverse internal and external shocks.