


## FINANCIAL VALUE CREATION

In this section / • Value based management • Working capital management • Financial review

**Value Based Management**

If a business is not profitable, it cannot continue to serve its stakeholders. It will be only a matter of time, and all stakeholders would be equally disadvantaged. To us, running the business profitably is the *sine-qua-non* of good management. Thus, financial value creation is deeply embedded into our management ethos.

In assessing our financial value creation, we have embraced 'Economic Value Added' (EVA) as the ultimate measure of success. Pioneered by Stern Stewart, EVA is a measure that indicates the creation or the destruction of wealth by a business. We have been using EVA as a tool and reporting on it consistently over the past several years. EVA takes into account all the money that is working for the business (total invested capital), and calculates the economic cost of it. If the profit after tax is higher than this economic cost, it is said that the business has created that amount of wealth. If the profit after tax is lower than the economic cost, it is said that the business has destroyed that amount of wealth.

 - The following table illustrates our computation of EVA In 2010/11, we have created Rs. 1,762 mn (Rs. 56 mn in 2009/10) of wealth.

**Economic Value Added - EVA**

As at 31st March	2010/11 Rs. '000	2009/10 Rs. '000
<b>Total Capital Supplied</b>		
Equity	4,200,847	2,200,928
Long-Term Interest - bearing Loans & Borrowings	408,757	662,383
	<b>4,609,604</b>	2,863,311
<b>Earnings</b>		
Profit after Tax	2,121,752	248,297
Add: Interest on Long-Term Borrowings	60,658	129,291
Adjusted Earnings	2,182,410	377,588
Weighted Average Cost of Capital (%)	9.11	11.24
Economic Charge	419,947	321,836
<b>Economic Value Added</b>	<b>1,762,463</b>	55,752

As at 31st March	Source	2010/11	2009/10
Average Risk Free Rate (Average Treasury Bill Rate)	Central Bank	7.50%	9.91%
Beta Factor - Dimo	CSE	0.85	0.87
Risk Premium	Assumed	2%	2%
All Share Price Index (ASPI)	CSE	7,217.00	3,724.60
Average Weighted Prime Lending Rate (AWPR)	Central Bank	9.84%	13.82%
Rate of Income Tax	Applicable Rate	35%	35%
Cost of Equity (Based on CAPM)	Computed	9.20%	11.65%
Cost of Debt (After Tax)	Computed	6.39%	8.98%

We also look at value added and the distribution thereof. Value added equals our revenue minus cost of goods and services purchased. It indicates the value that has been created by Dimo through the utilisation of its capacity, capital, manpower and other resources.

The following chart illustrates the creation of our value added and the distribution thereof. Our value added has grown significantly from Rs. 3,008 mn in the previous year to Rs. 9,183 mn in the year under review. A great part of the value added in 2010/11 has been retained in the business enhancing the Group's investment capacity very significantly. Likewise, the value distributed among Government by way of customs duties and taxation, employees and shareholders has also increased whilst the value distributed to lenders has reduced owing to reduced interest rates as well as retiring certain long-term loans owing to the cash surplus experienced during the year.

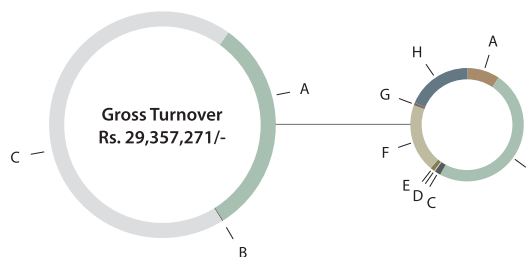
**Statement of Value Added**

For the Period of	Group				Company			
	%	2010/11 Rs. '000	%	2009/10 Rs. '000	%	2010/11 Rs. '000	%	2009/10 Rs. '000
Gross turnover		29,357,271		10,530,587		28,662,124		9,556,752
Other income		48,742		44,244		51,245		28,811
Less: Cost of material and services bought in		(20,222,537)		(7,566,628)		(19,740,634)		(6,859,852)
		<b>9,183,476</b>		<b>3,008,203</b>		<b>8,972,735</b>		<b>2,725,711</b>
<b>Value Shared With</b>								
Employees	11	1,037,261	24	717,616	11	945,365	23	626,952
Government	61	5,571,287	51	1,520,283	61	5,478,291	52	1,427,101
Lenders	02	207,674	12	365,746	02	207,184	13	344,001
Community Investment Donation	00	30,570	00	9,013	00	30,305	00	8,628
Shareholders	01	121,833	02	52,214	01	121,833	02	52,214
Retained in the business	24	2,214,851	11	343,331	24	2,189,757	10	275,443
Depreciation set aside	01	93,099	03	95,034	01	85,852	03	87,241
Profit retained	23	2,121,752	08	248,297	23	2,103,905	07	189,202
	<b>100</b>	<b>9,183,476</b>	<b>100</b>	<b>3,008,203</b>	<b>100</b>	<b>8,972,735</b>	<b>100</b>	<b>2,725,711</b>

**Group Value Added**

(%)

- A - Value Added: 31.2%
- B - Other Income: 0.2%
- C - Cost of Material and Services purchased: 68.7%



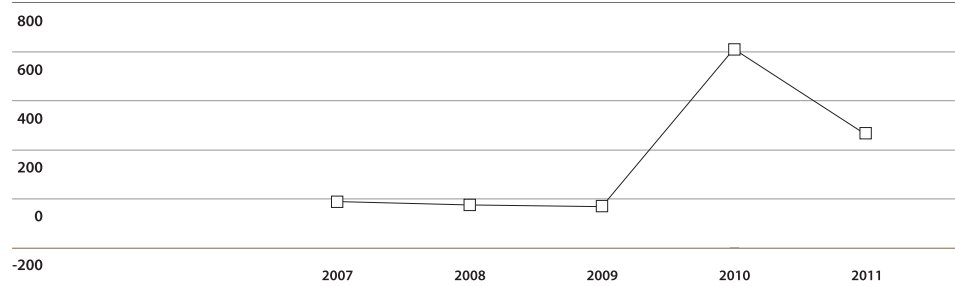
- A - Employees: 9.1%
- B - Government: 48.9%
- C - Lenders: 1.8%
- D - Community Investment Donation: 0.3%
- E - Shareholders: 1.1%
- F - Retained in the Business: 19.4%
- G - Depreciation set aside: 0.8%
- H - Profit Retained: 18.6%

- The following table illustrates the calculation of Total Shareholder Return (TSR). It includes capital gains from increases in share price as well as dividends received. TSR in the year under review is 264%.

Total Shareholder Return (TSR)	2011	2010	2009	2008
Market Price Per Share (Rs.)	1,484.7	424.75	61.00	88.75
Dividend Per Share (Rs.)	61.00	7.00	3.00	4.00
Shareholders Total Return (%)	263.91	607.78	(27.88)	(22.7)

**Total Shareholder Return**

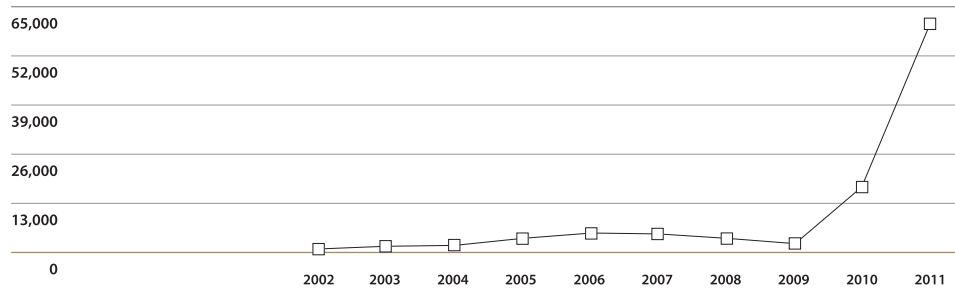
(%)



- Rs. 1,000/- invested in 2002 in Diesel & Motor Engineering PLC shares is worth Rs. 60,487/- today as shown in the chart below:

**Value of Rs. 1,000 Invested in 2002**

(Rs.)



**Working Capital Management** The efficient management of working capital continues to be a management prerogative and receives close attention of top management. There is a continuous monitoring of working capital based on certain internal KPI's that we have adopted.

Group Current Assets more than doubled from Rs. 3.38 bn to Rs. 7.84 bn during the year. Group Current Liabilities followed the same trend from Rs. 2.63 bn to Rs. 6.18 bn owing to the increased volume of trading. As a result, the Group's current ratio remained more or less unchanged at 1.27:1 as against 1.28:1 last year. The quick asset ratio however improved marginally from 0.79 to 0.84 from last year to the year under review. This is an indicator of a business's ability to satisfy its current liabilities with its most liquid assets and represents the current assets less inventories to current liabilities.

Inventories as at the year-end amounted to Rs. 2.64 bn compared to the Rs. 1.32 bn in the previous year. During the year under review, the Group's stocks residency period reduced from 60 days to 42 days. Debtors total as at year end was Rs. 3.32 bn compared to the 1.19 bn in the previous year.

During the year under review, the operational cash flow of the Group amounting Rs. 1.79 bn (Rs. 0.84 bn in 2009/10) was sufficient to finance working capital requirements.

**Financial Review Overview** The year under review was one of the most successful years enjoyed by the Group during the recent history. A relatively lower interest rate regime and reduced tariff for passenger vehicles were two key driving factors for this performance. Favourable changes in the business environment experienced during the latter half of the previous financial year prompted the Group to welcome the financial year under review with a strengthened resource base in order to take advantage of the opportunities that were presented by the conducive business climate.

A phenomenal increase in turnover accompanied by a corresponding increase in net profit, generation of a significant amount of funds through operations, and investments made in working capital and property, plant & equipment (PPE) are key highlights for the financial year under review. Funds generated during the year leaves the Company with resources to provide the platform for future sustainable growth.

**Financial Environment** Interest rates, economic growth, exchange rates and intensity of economic activity are some economic and financial aspects that influence the performance of the Group. The Group provides capital goods such as vehicles, equipment, machinery & infrastructure, which are often funded by the customers through borrowings. Borrowing rates is a key consideration that determines the demand for capital goods sold by the Group. On the other hand, borrowing rates make an impact on the net financing cost of the Group. Lower rates of interest, therefore, is a prerequisite to a successful performance.

Table below provides the quarterly segment revenue and results turnover together with relevant key indicators of financial and economic environment.

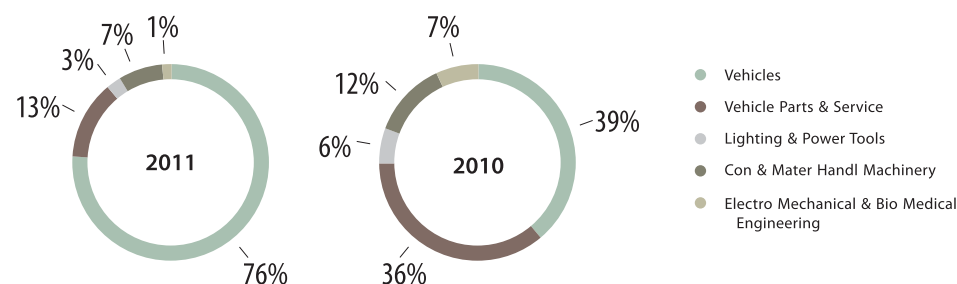
FINANCIAL VALUE CREATION

Quarterly Performance and Economic Indicators

Segment Performance		2010/11 (Rs. '000)					2009/10 (Rs. '000)				
		1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Vehicle	Revenue	2,120,665	3,729,272	9,543,479	6,705,695	22,099,111	472,995	1,008,964	1,519,854	2,275,394	5,277,207
	Results	216,670	523,258	1,486,348	992,754	3,219,030	18,250	50,683	131,258	265,108	465,299
Vehicle Parts & Service	Revenue	659,831	650,758	729,590	781,563	2,821,742	537,992	678,138	590,380	747,046	2,553,556
	Results	(7,572)	216,490	68,486	252,343	529,747	90,618	150,812	100,416	90,489	432,335
Lighting & Power Tools	Revenue	112,519	143,705	373,178	268,731	898,133	66,394	109,138	106,862	118,303	400,697
	Results	277	32,454	44,123	31,931	108,785	9,083	17,682	27,012	17,720	71,497
Construction, Agricultural & Material Handling Machinery	Revenue	408,551	769,749	1,108,122	707,520	2,993,942	176,236	411,027	370,826	559,216	1,517,305
	Results	(25,470)	127,959	109,590	91,930	304,009	12,451	28,947	36,079	67,412	144,889
Electro - Mechanical and Bio Medical Engineering	Revenue	116,376	38,173	286,058	103,736	544,343	132,795	382,456	162,695	103,876	781,822
	Results	23,649	61,896	847	(25,392)	61,000	31,022	31,133	10,986	10,453	83,594
<b>Total Revenue</b>		<b>3,417,942</b>	<b>5,331,657</b>	<b>12,040,427</b>	<b>8,567,245</b>	<b>29,357,271</b>	<b>1,386,412</b>	<b>2,589,723</b>	<b>2,750,617</b>	<b>3,803,835</b>	<b>10,530,587</b>
<b>Total Results</b>		<b>207,554</b>	<b>962,057</b>	<b>1,709,394</b>	<b>1,343,566</b>	<b>4,222,571</b>	<b>161,424</b>	<b>279,257</b>	<b>305,751</b>	<b>451,182</b>	<b>1,197,614</b>
<b>Economics Indicators</b>											
Exchange Rate (Quarter beginning)	US\$	114.82	114.36	112.84	111.82		116.65	115.83	115.59	115.27	
	Euro	155.8	140.03	154.86	149.55		154.76	163.07	169.82	165.9	
AWPLR (Quarter beginning) (%)		10.62	10.37	9.91	8.92		19.6	15.54	12.88	10.91	
Inflation (12 months moving average)		3.4	4.2	5.4	6.00		16.7	10.4	5.2	3.1	
GDP Growth (%)					8.00					3.50	

Composition of Gross Profit by Segment

(%)

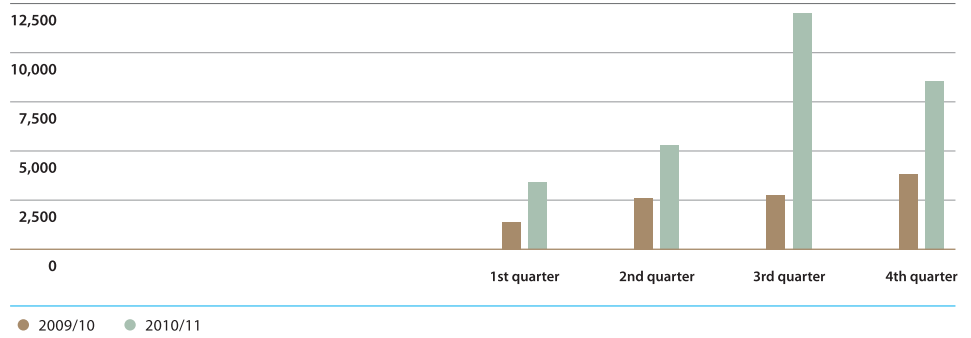


**Financial Performance**  
**Turnover**

The Group turnover recorded an unprecedented growth of 179% increasing from Rs. 10.4 bn to 29.4 bn. This also represents an achievement of 61.05% over the budgeted turnover. Whilst the vehicles segment led the growth in turnover, vehicle parts and service, lighting and power tools, constructions and material handling machinery segments too contributed in a significant manner. The assets turnover ratio increased from 1.88 to 2.65 providing an indication of the manner in which the assets of the Company have been utilised in generating the turnover.

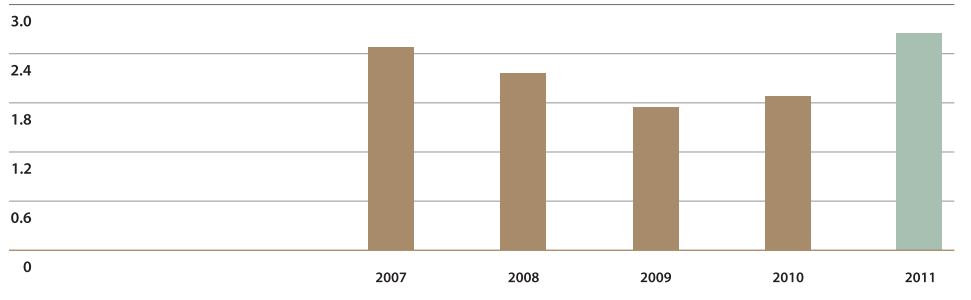
**Gross Turnover**

(Rs. mn)



**Asset Turnover**

(Times)

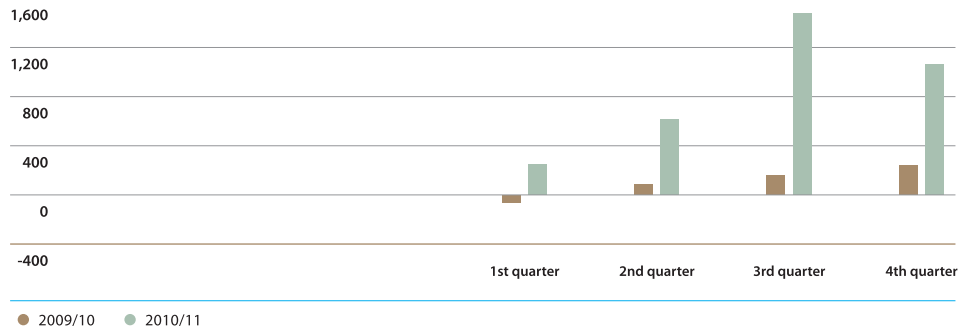


FINANCIAL VALUE CREATION

**Profitability** The gross profit ratio reduced from 22.91% to 20.56%. Lower gross profit ratio in the vehicles segment was a key reason for the reduction in the overall gross profit ratio.

**Profit Before Tax**

(Rs. mn)

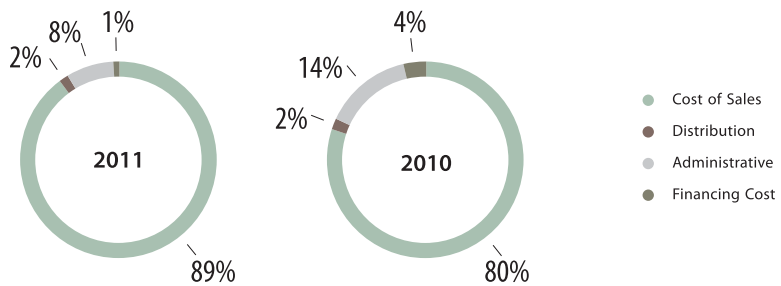


**Administration and Distribution Expenses**

Administration and distribution expenses have increased by 46% over the previous year. This expense increased with increase in turnover. Promotional costs and staff costs were two key components that accounted for the increase. The ratio between the above expense and turnover reduced from 15.87% to 8.32% this year.

**Cost & Expenses**

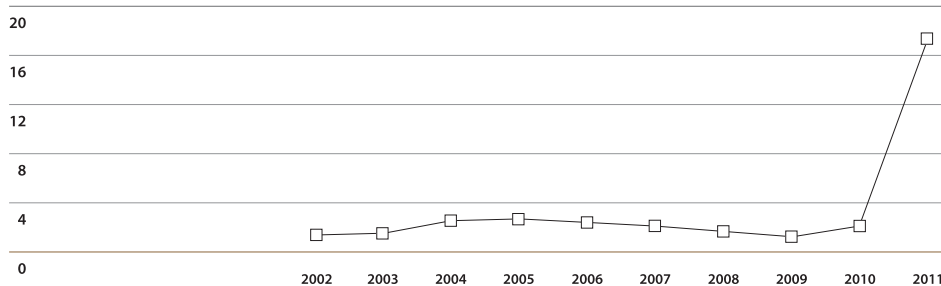
(%)



**Net Finance Cost** Reduced interest rates and cash generated from operations helped to reduce net finance cost by 43%, resulting in a reduction in net finance cost from Rs. 365.8 mn to Rs. 207.7 mn. Increased net profit and reduced interest cost increased the interest cover from 2.15 to 17.35. Net financing cost which is usually a significant component of the cost structure of the Group was made less significant with the increase in profits.

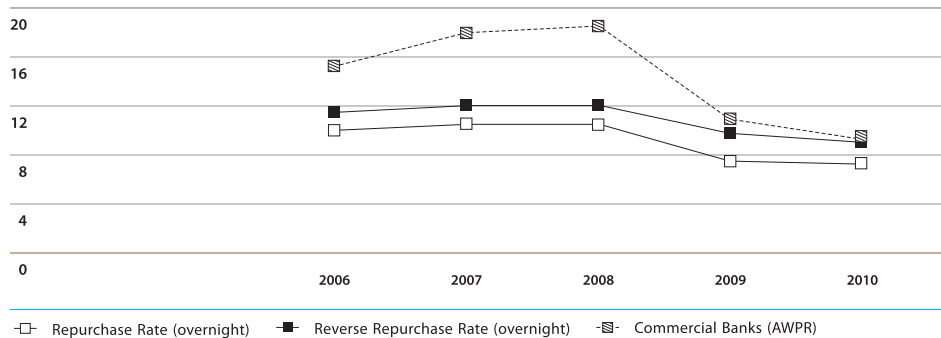
### Interest Cover

(Times)



### Interest Rates

(%)



**Taxation** The income tax expenses increased from Rs. 141.8 mn to Rs. 1,274.2 mn, with the increase in net profit before tax. The Company and its subsidiary were liable for income tax at 35%. The rate of income tax has reduced to 28% with effect from 1st April 2011. The effective tax rate shows a reduction from 38.48% to 35.57% due to proportion of the disallowable expenses being less than previous year. The reconciliation between accounting profits and taxable income is available in Note 12.1 on page 178.

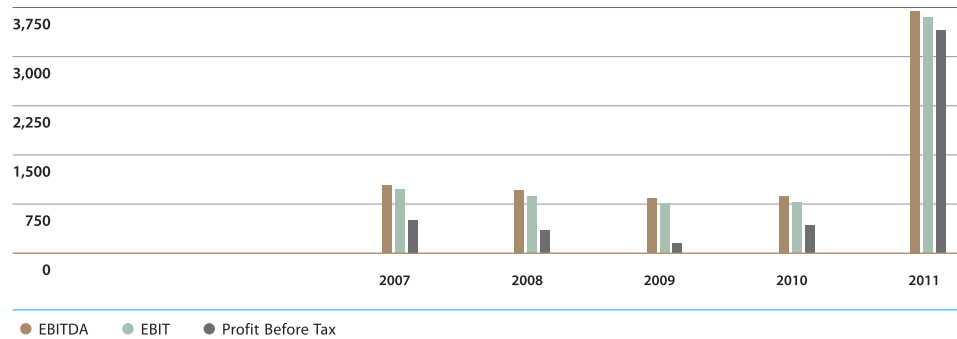
**Deferred Taxation** The tax expense include a charge of Rs. 30.02 mn in respect of deferred tax. A summary of the deferred tax computation is available in Note 29 to the Financial Statements.

FINANCIAL VALUE CREATION

**Earnings** Earnings before interest and tax (EBIT) increased from Rs. 785.9 mn to Rs. 3,603.7 mn. Net profit after tax also increased from Rs. 248.3 mn to Rs. 2,121.8 mn. Return on average capital employed increase was 39.86% compared to 13.83% last year. Earnings per share for the period under review was Rs. 239.03 compared to Rs. 27.97 last year. There was no changes in the number of shares in issue, during the year.

**Earnings**

(Rs. mn)



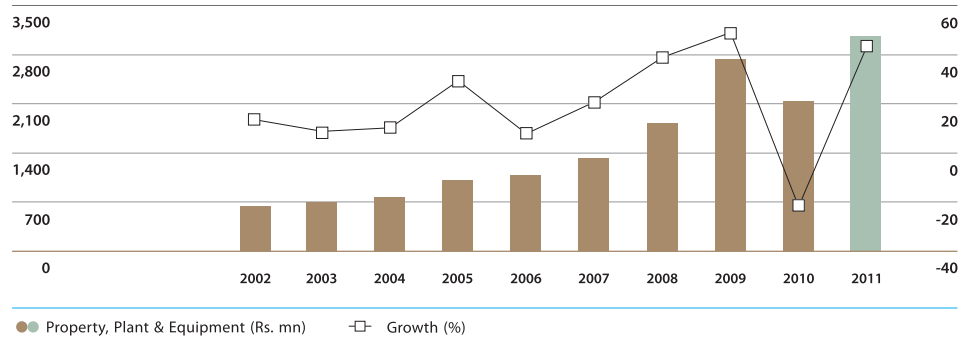
**Financial Position**  
**Property, Plant and Equipment**

The Group invested a total of Rs. 1,044.6 mn (2009/10 - Rs 36.9 mn) in property, plant & equipment. The Company acquired a property within the Colombo municipal limits and in close proximity to the head office investing Rs. 715.52 mn. The property is 614 perches in extent and has a warehousing complex covering an area of approximately 67,000 square feet. The total investment in plant & machinery amounted to Rs. 111.7 mn (2009/10 - Rs. 10.3 mn).

**Growth in Property, Plant & Equipment**

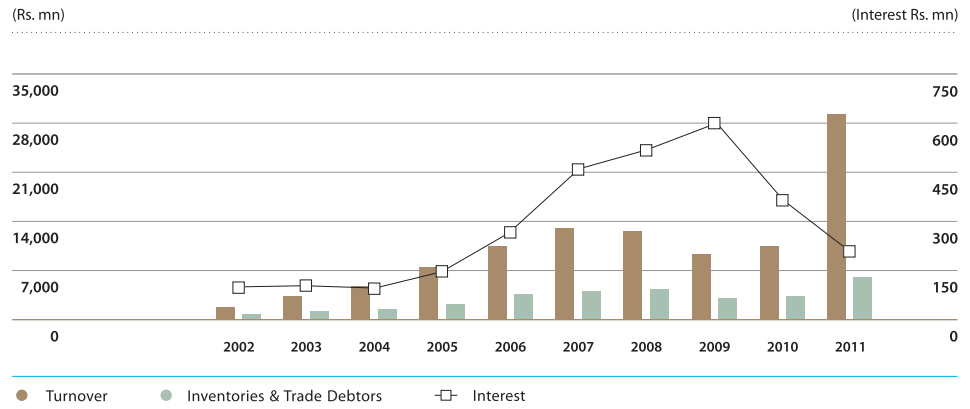
(Rs. mn)

(%)



**Working Capital** The increased level of activity has placed demands on management of working capital and is receiving due attention. Higher turnover also resulted higher levels of inventory and receivables, increasing current assets from Rs. 3,350 mn to Rs. 7,848 mn. Inventories increased by 100.1% from Rs. 1,316.3 mn in the previous year to Rs. 2,640 mn. Trade and other receivables too increased by 67.4% from Rs. 1,988 mn to Rs. 3,328.4 mn.

**Inventories & Trade Debtors vs Turnover, Interest**

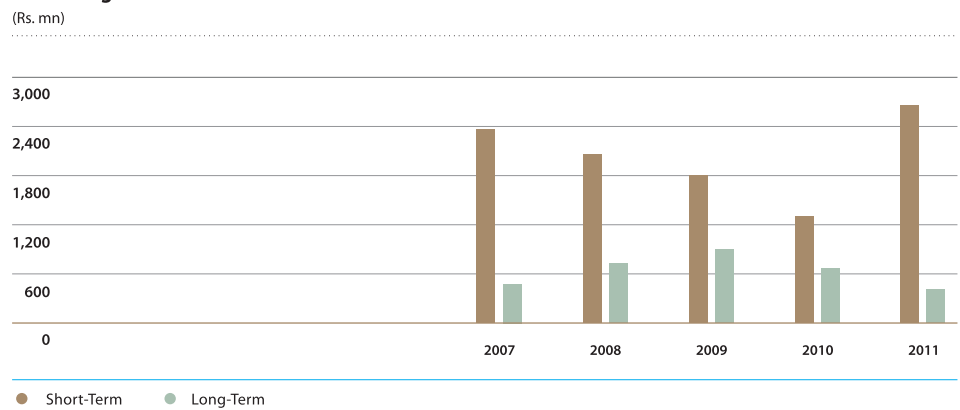


**Borrowings** Borrowings consist of term loans, import loans, short-term loans and overdraft. The total amount of term loans outstanding as at the year-end amounted to Rs. 408.8 mn. (2009/10 - Rs. 662.9 mn), indicating a reduction of approximately 38%. The term loans have been obtained for a five-year repayment period except for the loan obtained to finance the acquisition of Weliweriya complex, which has a repayment period of ten years.

Interest rates of overdrafts are reviewed periodically and rates charged on short term/import loans are determined based on money market rates. Group's interest bearing borrowings marginally decreased during the year.

More details on borrowings are available in Note 30 to the Financial Statements.

**Borrowings**



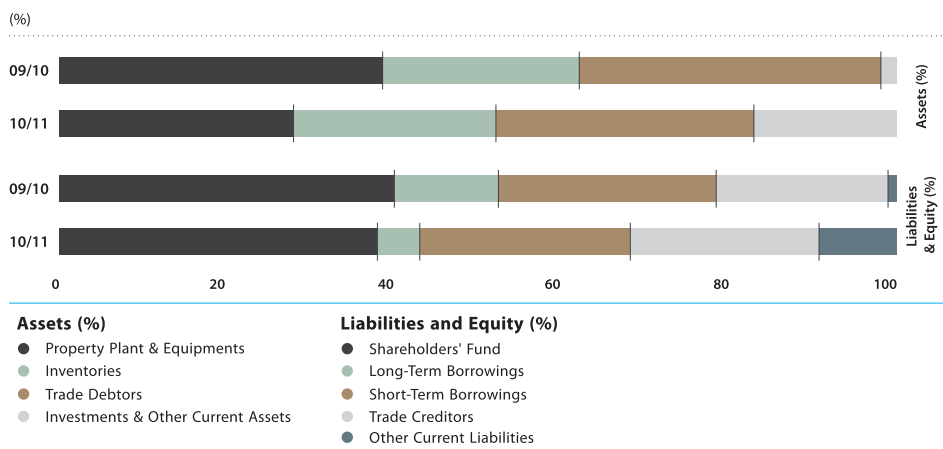
FINANCIAL VALUE CREATION

**Solvency** Section 56 of the Companies Act No. 07 of 2007, requires that a solvency test be performed prior to the payment of dividends. In order to satisfy this requirement, the Company carried out solvency tests prior to payment of the two interim dividends. As per requirements of the above Act, the Company Auditors certified prior to payment of interim dividends that the Company has the ability to pay its debts as they become due in the normal course of business and that the value of the Company’s assets is greater than the value of its liabilities and the Company’s stated capital.

Given below is the computation of solvency for the Company as at the year-end.

<i>As at 31st March</i>	2011 Rs. '000	2010 Rs. '000
Non-Current Assets	3,073,840	2,106,683
Current Assets	7,476,574	3,092,153
<b>Total Assets</b>	<b>10,550,414</b>	<b>5,198,836</b>
Current Liabilities	6,041,877	2,545,392
Non-Current Liabilities	555,674	682,653
<b>Total Liabilities</b>	<b>6,597,551</b>	<b>3,228,045</b>
Assets Less Liabilities	3,952,863	1,970,791
Stated Capital	182,500	182,500
	<b>3,770,363</b>	<b>1,788,291</b>

**Balance Sheet Structure**



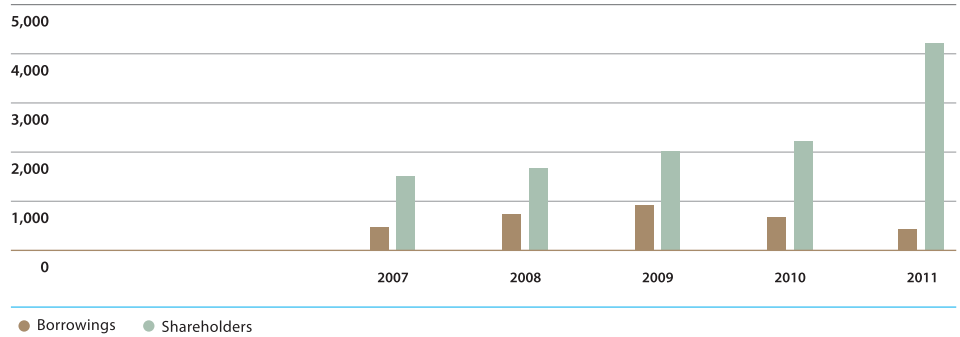
**Cash Flow** The Group generated funds amounting to Rs. 1,794 mn (2009/10 - Rs. 846.8 mn) from operations during the year under review. This was after supporting an increase of inventory and receivables (net of payables) amounting to Rs. 1,409.8 mn. Funds amounting to Rs. 1,082.2 mn (2009/10 - Rs. 36.46 mn) was utilised for acquisition of property, plant & equipment during the year. Cash and cash equivalents increased by Rs. 478.48 mn (2009/10 - Rs. 526.67 mn) during the year.

The Group possesses the necessary banking facilities to support its operations. Cash generation from operations and available banking facilities was adequate to finance working capital, capital expenditure, dividends and statutory payments.

**Debt to Equity Ratio** The Group's debt to equity, which is calculated as a proportion of the total interest-bearing borrowings to equity decreased to 73.04% (2009/10 - 89.35%). Increase in the Shareholders' funds from Rs. 2,200.93 mn to Rs. 4,200.85 mn was the reason for the reduction in the Debt to Equity Ratio.

### Capital Structure

(Rs. mn)

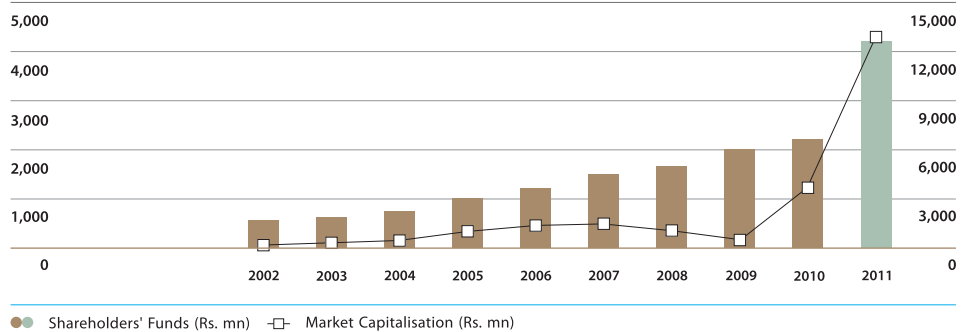


**Shareholders' Funds** The shareholders' funds, propelled by the retained earnings for the year increased from Rs. 563.53 mn to Rs. 2,213.44 mn as at 31st March 2011. The details of the movement in shareholders' funds are given in the Statement of Changes in Equity on page 156.

### Shareholders' Funds Vs Market Capitalisation

(Shareholders' Funds Rs. mn)

(Market Capitalisation Rs. mn)



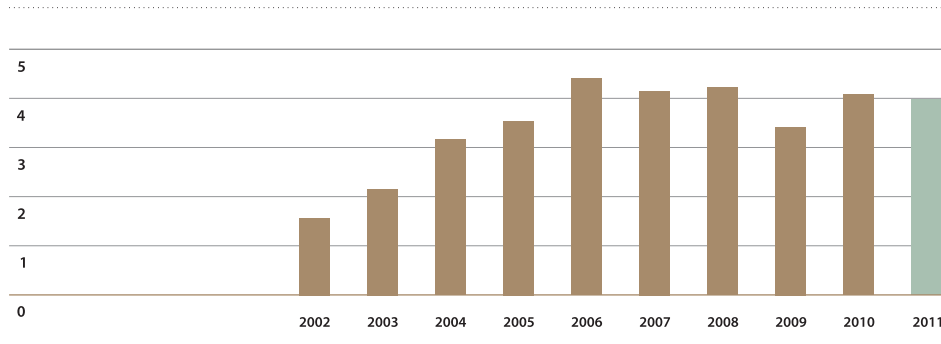
FINANCIAL VALUE CREATION

**Retirement Benefits** The actuarial valuation of the gratuity liability carried out as at the year-end places the Group's liability at Rs. 182.3 mn compared to that of the previous year of Rs. 142 mn. This liability has been recorded in the Financial Statements accordingly. Details of the assumptions made in carrying out the actuarial valuation are set out in Note No. 28 to the Financial Statements. The charge to the Income Statement for the year on account of the gratuity liability is Rs. 57.7 mn, which was Rs. 28.2 mn for the year 2009/10.

**Stakeholder Financial Implications**  
**Shareholders - Dividends** The Company paid two interim dividends during the financial year. Each interim dividend was at Rs. 5/- per share (2009/10 - interim dividend Rs. 3/- and final dividend of Rs. 4/-). The total outflow for the dividend amounted to Rs. 121.83 mn. The Directors also approved a final dividend consisting of Rs. 23.10 per share cash dividend and a Rs. 27.90 per share scrip dividend, totalling to Rs. 51/- per share. The Company possessed necessary funds to finance the dividend payments and satisfied the solvency test requirement for payment of dividends as laid down in the Companies Act No. 07 of 2007.

**Dividend Cover**

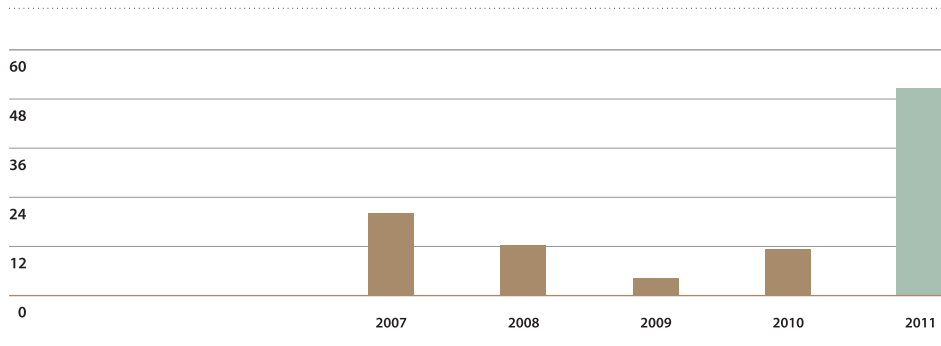
(Times)



**Shareholders - Return on Equity** ROE increased to 50.51% (2009/10 - 11.28%) consequent to the higher profit after tax.

**Return on Equity**

(%)



**Market Value Added (MVA)** Market value added is the difference between the current market value of the Company and the capital contributed by the investors. i.e shareholders' equity. MVA is an indicator of shareholder wealth unlike EVA which is a performance measure. A positive MVA indicates the market's confidence in the future stream of EVAs.

The computation of MVA of the Company is shown below:

<i>As at 31st March</i>	2010/11 Rs. '000	2009/10 Rs. '000
Market Capitalisation	12,920,437	3,696,340
Shareholders' Funds	(4,200,847)	(2,200,928)
Market Value Added	8,719,590	1,495,412

MVA as at year end showed a positive value of 8.72 bn. (2009/10- Rs. 1.49 bn.) This is mainly due to tremendous performance of market price of the shares.

**Suppliers** Payment to local suppliers amounted Rs. 3.9 bn (2009/10 - Rs. 1.8 bn).

**Employees** Rs. 1,037 mn (2009/10 - Rs. 717 mn) out of value added through operations was shared with the employees. This amounts to an increase of 45.5% (2009/10 -15.4%).

**Society** Expenditure incurred during the year for the direct benefit of the society was Rs. 30.5 mn (2009/10 - Rs. 9.01 mn).

**Financial Operations**  
**Treasury Management** The Group operates a central treasury function. It controls decisions in respect of cash management, utilisation of borrowing facilities, banking relationships and foreign currency exposure management. Further it enables effective cross utilization of funds between Business Units.

**Financial Market Risk** The Company is exposed to changes in financial market conditions such as fluctuations in interest rates and foreign currency exchange rates. Increases in interest rates could have a significant impact on the net finance cost. Forward exchange rate contracts may be entered into, on a selective basis.

## FINANCIAL VALUE CREATION

**Accounting and Financial Reporting**

The Group strives to make meaningful disclosures of material information in the annual report and accounts and has consistently focused on improving the presentation of information, within the framework of the Sri Lanka Accounting Standards.

It remains committed to the adoption of best practices in its communications with shareholders and other users of Financial Statements within the bounds of commercial confidentiality, to enable them to make informed judgments on the performance of the Group.

**Financial Priorities**

The financial performance for the year under review, and the forecasts into the immediate future, directed the Company's priorities towards focusing on sustaining growth and managing the funds generated. These necessities have given rise to the following priorities.

1. Rational utilisation and investment of funds generated.
2. Prudent management of costs ensuring that inefficiencies do not get hidden in success.
3. Management of working capital in view of the demands placed by strong growth in turnover.

The above measures are integrated with the identified long-term financial priorities that are strongly pursued in formulating Corporate Strategy. The following are the Group's financial priorities that drive the Group's financial strategy:

- Optimising profitability through value addition and efficient utilisation of resources, particularly through prudent working capital management.
- Striking a balance between growth and immediate profitability in allocating financial resources.
- Maintaining a healthy Balance Sheet.

**Financial Outlook 2011**

The relatively lower interest regime provided an enabling environment for a successful year. The reduction in tariff also provided the much needed kick start for the passenger vehicle sales. The present economic conditions do not suggest a reversal of fortunes in the near future although the Government Policy on tariff on motor vehicles is unclear.

Financial budgets for the year 2011/12 indicate another year of successful financial performance. Realisation of such a prospect would lead to further strengthening of the Group's financial position, with the ultimate beneficiaries being its stakeholders.